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the United Kingdom and the United States of America**

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***QUI TAM* LEGAL CONCEPT AND PRACTICE: EVOLUTION OF THE LEGISLATION IN THE UNITED
KINGDOM AND THE UNITED STATES OF AMERICA**

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Abstract

Qui tam is the process whereby an individual sues or prosecutes in the name of the government and shares in the proceeds of any successful litigation or settlement. The Latin name points to the long history of the legislation, which was created in the ancient times. The *qui tam* authorises private citizens with non-public information relating to the fraud to bring suit on behalf of the government even without prosecutorial endorsement. *Qui tam* is generally a civil procedure, and the individual need not have been a victim of the misconduct.

The aim of this research is to contribute to the original knowledge by providing an analysis of the *qui tam* legal concept in its historical evolution in a space of time through two millennia, with main focus on two primary common law jurisdictions – the United Kingdom and USA.

The hypothesis underlying the research is that under certain conditions pursuing goal to better and more efficiently exercise some of its functions the state following qualitative changes in a socio-economic environment may delegate part of its authority to the citizens, and provide them with selectively adopted set of pecuniary and non-pecuniary incentives to accept this authority. The hypothesis is tried with analysis from the following perspectives: macro level - state regulatory practice, and socio-economic development; corporate level -- cost of compliance, and corporate response; basic level -- personal motives, and risks for actual and potential whistleblowers.

The conceptual framework applied is based on the economic analysis of law, which focuses on the economic efficiency of legal rules. The starting point of the research is the assumptions that legal rules ought to be efficient, and that individuals respond to legal rules economically. However the analysis goes beyond the fundamentalist strong-form rationality assumption,

which implies that economic agents always make choices that maximise their own welfare. For the purposes of this research, the people are viewed as weakly rational – rational, but subject to some consistent deviations. Methodologically the research borrows from the behavioural economic theory its attention to such factors as frame dependence and inefficient markets.

The analysis shows that *qui tam* regulations have decentralised the problem of enforcement, which apart from tackling the inevitable bureaucratic inaptitude, significantly reduces its costs. With respect to more traditional forms of monitoring and regulatory control such a system has proven to offer solid advantages. First of all, it does not require setting up a costly structure. The financial sophistication, and organisational complexity, combined with technical ingenuity and elaboration of the contemporary big business present a cognitive challenge for the investigative and prosecutorial agencies. To investigate white-collar crime they have to spend increasingly huge resources, both financial and intellectual. The relative scarcity of these resources in the post-crisis developed economies has paved way for the *qui tam* legislation to give governments chance to catch up.

From the narrow regulatory point of view, the bounty system imposes a downward shift in costs of compliance – from the regulator to a corporate level, – because it does not require significant increase in regulators’ staff and budgets. The macroeconomic approach, which focuses on the costs and benefits on a much wider scale, brings in a more complicated picture, when potential short-term increase in costs on a corporate level are offset on a longer-term time scale by rising economic efficiency as a result of reduced losses through corporate fraud and government imposed fines, increased public trust, and improved corporate governance.

From the point of view of the lawmakers, by creating competition for enforcement, *qui tam* laws reduce the chances that the potential enforcer is bought off, thus providing some additional efficiency through the dual enforcement model. This leads the research to conclude on the motives and logic that stand behind the state, which in such way delegates part of its authority: the *qui tam* have always been popular with ruling classes for the same reason in the past as well as at present times – under public pressure to prosecute more effectively misdeeds and fraud the society decries as unacceptable, legislative bodies enhance *qui tam*, when they consider the enforcement of some law beyond the unaided capacity, or interest of law enforcement officials.

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Introduction

The aim of the research is to describe and analyse the *qui tam* legal concept as a complex legal phenomenon in its evolution in a space of time as long as 20 centuries in primary common law jurisdictions – the United Kingdom and USA.

The phrase “*qui tam*” comes from a longer one -- *qui tam pro domino rege, &c, quam pro se ipso in hac parte sequitur*”, which might read in full as “he who brings this following matter for my Lord the King and who as well who brings this following matter for himself.”¹

Though it would be unfair to claim that *qui tam* is an obscure legal concept, while in fact it is rather well represented in academic literature, as well as in professional publications for acting lawyers. However, the focus of analysis has been so far on just one of its aspects – incentives for and status of whistle-blowers. Indeed, in the eyes of the US lawmakers and power wielding agencies *qui tam* is a delegation of some prosecutorial authority to the whistle-blowers, who step in the shoes of the government to bring to the court of law cases to fight alleged wrongdoings.

What is customarily omitted is the other side of the power sharing equation -- the state. When someone is authorised to exercise some prosecutorial powers, it means the state disperses part of its authority to a citizen. The motives of the altruist whistle-blowers – the activist

¹ Blackstone explained that the phrase “*qui tam*” originates from the one, which he abbreviated to *qui tam pro domino rege, &c, quam pro se ipso in hac parte sequitur*” (Blackstone, pp. 161-162 [online] available at: < <http://www.lonang.com/exlibris/blackstone/> > (accessed on 4 September 2014). Taking the “&c” into account, the phrase English reading might be as follows: “He who brings this following matter for my Lord the King and who as well who brings this following matter for himself.” In any event, later courts and commentators usually drop at least the “&c” from Blackstone’s quote, see e.g., *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 768 n.1 (2000)

citizens, driven by some sense of a moral duty – are relatively well analysed in academic literature. The same can be said about *qui tam* relators -- not so altruist citizens, motivated primarily by the pecuniary considerations, or bounty they receive as a part of the remedial proceeds.

The motives and logic that stand behind the state, which delegates part of its authority, are limited to the observation, that *qui tam* have always been popular with ruling classes for the same reason in the past as well as at present times: legislative bodies have authorised it when they consider the enforcement of some law beyond the unaided capacity (or interest) of law enforcement officials².

Sometimes *qui tam* is misunderstood as an American invention attributed to the more or less modern times – XIX century, when in a midst of the Civil War the Congress passed the False Claims Act, aimed at tackling fraud in government procurement by offering huge bounties to those relators, who would bring the cases to the court of law.

The fact that *qui tam* has existed since the ancient times remains obscured, although it is well known to those scholars, who declared their opposition to it. Those who are well introduced to the long history of this legal principle, mostly view it as a “barbarous relic”, following the famous remark of the British economist John Maynard Keynes³. They argue that *qui tam* was a necessary tool, which empowered underdeveloped executive powers of the ancient and medieval sovereigns to exercise prosecution more effectively, and keep proper order among their subjects⁴. The rise of a modern state, capable to police, investigate, and prosecute

²S. Rept. No. 77-1708, at 2 (1942), and H. Rept. No. 78-263 at 2 (1943), each quoting from a letter by Attorney General Biddle

³ Keynes, J.M. (2000). *A Tract on Monetary Reform*. Prometheus Books, p. 172

⁴ Beck, J.R., *The False Claims Act and The English Eradication of Qui Tam Legislation*, 78 **North Carolina Law Review** 539-642 (1999-2000); Deutsch (2010), *supra* note 140 at 35

wrongdoings and offenses in the society, makes *qui tam* irrelevant, and ultimately redundant. Moreover, some argue that the very concept of a modern police force and prosecution is undermined by the existence of *qui tam*. The invective “viperous vermin”⁵, -- used in the XVII to decry those who abused *qui tam* laws as delators, damaging social homogeneity and economic stability, -- from the point of view of the modern critics, is even more applicable to the contemporary *qui tam* relators⁶.

While such criticism warrants some merits the underlying logic fails properly explain the fact that *qui tam* has enjoyed a revival and expansion since the 1980s, and at present, it is turned into all-powerful weapon by the US Congress.

The research question of this work therefore is: what makes the *qui tam* a viable concept, in spite of being abolished in the UK, it resurrected in the USA, and to date has much wider scope than 150 years ago – now it is related not only to the fraud with government procurement, but to all sorts of wrongdoings in a financial sector? And can *qui tam* enjoy revival, and expand even further to be employed in criminal prosecution?

For the purposes of this research the *qui tam* is examined as one of a dual nature, stemming from interaction between a state and an activist part of its citizenry. This approach puts more emphasis on an underlying logic and motivation of the executive branch to cede part of its

⁵ Coke, E. (1669). *The Third Part of the Institutes of the Laws of England*, [online] available at: <<http://books.google.co.uk/books?id=E5A0AAAIAAJ&printsec=titlepage#v=onepage&q&f=false>> (accessed on 29 August 2011), p.194

⁶CATO Institute repeatedly pointed out that *qui tam* actions had the potential to seriously damage US economy. Its experts were actively involved in successfully challenging constitutionality of the *qui tam* provisions of the US Patent Law (see: <http://www.cato-at-liberty.org/catos-first-brief-in-a-patent-case-on-constitutional-grounds/>)

authority to the citizens, rather than on a set of rules encouraging people activists to combat fraud by a mix of pecuniary and non-pecuniary incentives.

The scope of research extends to the analysis of the interaction between the state and whistle-blowers (actual and potential) with the third party always present – the corporate sector, as a main target of relators' activities. As if emphasising that the prime suspect is the big business US lawmakers introduced a threshold of \$1 million remedies a potential *qui tam* case may bring to qualify for bounty⁷. Although the critique of the *qui tam* based on the assumptions about its dubious moral grounds and potential to undermine social stability⁸ does not prove to have much ground, the ability of *qui tam* actions to raise the costs and reduce efficiency in corporate sector, as some of the unforeseen externalities of the new legislation begin to bite, requires additional research.

The hypothesis underlying this research is that under certain conditions pursuing goal to better and more efficiently exercise some of its functions the government following qualitative changes in a socio-economic environment may delegate part of its authority to the citizens, and provide them with selectively adopted set of pecuniary and non-pecuniary incentives to accept this authority.

⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (*An Act to Promote the Financial Stability of the United States by Improving Accountability and Transparency in the Financial System, to End 'Too Big to Fail', to Protect the American Taxpayer by Ending Bailouts, to Protect Consumers from Abusive Financial Services Practices, and for Other Purposes*), Pub. L. 111-203, H.R. 4173. Other names of the statute include *Financial Reform Act* and *Financial Transparency and Accountability Act*. Hereafter the Dodd-Frank Act is cited from: <<http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173ENR/pdf/BILLS-111hr4173ENR.pdf>> (accessed on 27 November 2014)

⁸ De Maria, W, (2001). *Designing Dynamic Disclosure Law*. Submission to the Senate Finance and Public Administration Legislation Committee Inquiry into the *Public Interest Disclosure Bill 2001* [online] available at: <www.aph.gov.au/~media/wopapub/senate/sub02_doc.ashx> (accessed on 2 October 2015)

The hypothesis will be tried with analysis from the following perspectives: macro level - state regulatory practice, and socio-economic development; corporate level -- cost of compliance, and corporate response; basic level -- personal motives, and risks of actual and potential whistle-blowers.

On a macro level, the advent of global corporations stemming from the paradigm shift in production toward the network model, and deregulation of financial markets, has fostered their growing power and effectiveness beyond and above the boundaries of nation states⁹. The global corporations have effectively surpassed the jurisdiction and authority of the state in the countries of their origin. At the same time the financial sophistication, and organisational complexity, combined with technical ingenuity and elaboration of the contemporary big business present a cognitive challenge for the investigative and prosecutorial agencies in the modern states. To investigate white-collar crime they have to spend increasingly huge resources, both financial and intellectual.

In theory, the law enforcement can respond along the following lines:

- By adopting supranational legislation, and developing supranational organisations, wielded with powers and authorities, transferred from the national level;
- By strengthening international cooperation in corporate crime investigations between the national peers, and developing relevant regulatory frameworks;
- By increasing efforts and allocating additional resources on a national level;
- By adopting new legislation with a purpose to decriminalise what currently constitutes corporate crime.

⁹ Hardt, M. and Negri, A. (2000). *Empire*. Harvard University Press, Cambridge and London, p. xii

So far the predictions about the rise of the international organisations has only partially come to fruition -- the body of supranational laws may impress none, but the members of the European Union; international cooperation is in constant fight with beg-thy-neighbour mentality; and the only way to stand up to the challenge is to constantly increase the efforts on a national level.

Nationally decriminalisation still remains theory, and national governments after the latest financial crisis combined with what is called the Great Recession is under significant financial stress. The budget that they can allocate to the corporate fraud investigations is limited at best in an era of austerity and budget cuts. The ability of governments to borrow also challenged. Taking in consideration that from the historic perspective, the rise of the government bureaucracies and state budgets, based on extensive taxation, is a relatively young phenomenon of the late XIX-XX centuries, it is possible to hypothesise that governments may employ selected relevant elements of policies from not so far past. Thus, before the formation of the colonial administrations into formidable power structures the British and Dutch governments in XVII-XVIII centuries effectively exercised control over vast parts of their colonial empires through the private enterprises – the respective East India companies¹⁰. This legacy is unlikely to be recovered, but the *qui tam* is here to stay, and has potential to expand further.

From narrow regulatory point of view, the bounty system imposes a downward shift in costs of compliance – from the regulator to a corporate level – because it does not require

¹⁰ The Dutch East India Company was dissolved in 1800 (Ricklefs, M.C., (1991). *A History of Modern Indonesia Since c.1300*, 2nd ed. MacMillan, London. p. 110); the British East India Company was brought under the Queen's rule in 1858, and dissolved in 1874 (Lawson, Ph., (1993). *The East India Company: A History*. Addison Wesley Longman, Harlow. pp. 160-163)

significant increase in regulators' staff and budgets. The macroeconomic approach, which focuses on the costs and benefits -- while affecting the national economy -- shifts to the corporate level the problem of the externalities brought by the new regulation. This problem arises in a peculiar inverse version of the Pigouvian framework¹¹ of approach to regulation: the externalities of the Government intervention reduce the efficiency of the market and damage the economy¹². Though assessing the extent of such damage is not a straightforward task -- thus, while indicating what the cost of different elements of the financial reform will be analysts sometimes miss to assess the ability of corporations to generate new revenue streams to offset the ones that are being lost. As a result, the externality of the reform may start bite, and this in its turn will require new legislative efforts to repair the externality, so that the resulting accumulated economic costs of the new regulations may turn out to be higher than expected.

On a corporate level the expansion of *qui tam* to some extent reflects the failure of the legal view on who should lead the fight against corporate fraud -- i.e. shareholders. They do not. According to Dyck *et al.*, 11.2-13.6 per cent of all firms in the US have on-going fraud, of which only 3.2 per cent are eventually caught. As a result, estimated up to 3.5 per cent of equity value is lost due to fraud¹³. Another research shows that the percentage of fraud detected by whistle-blowers jumps from 14 to 41 per cent when moving from financial to healthcare fraud, where the False Claim Act with its *qui tam* provisions applied at the time of the research¹⁴.

¹¹ Pigou, A., (1938). *The Economics of Welfare*, MacMillan, London

¹² Zingales, L., *The Future of Securities Regulation* (29 January 2009). Chicago Booth School of Business Research Paper No. 08-27; FEEM Working Paper No. 7.2009. [online] Available at: <http://ssrn.com/abstract=1319648> or <http://dx.doi.org/10.2139/ssrn.1319648> (accessed on 30 April 2010)

¹³ Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, 65 **Journal of Finance** 2213 (2010)

¹⁴ *Ibid.*

On a basic level – personal – the analysis' prime focus is on the potential whistle-blowers, though it is worth mentioning that the *qui tam* not necessarily implies whistle-blowers -- presumably the corporate employees who disclose corporate fraud. The *qui tam* concept deals with "relators", who may be most likely, the employees, but as well may be a third party, who is in possession of the relevant information.

Whatever they can be the key question remains the same: What is the real personal cost to blow the whistle? Potential relators would weigh the possibility of a reward against a number of opposing considerations: the likelihood of information they submitted actually being used, and whether the use would result in a successful legal proceeding; whether they would lose their own income; whether they would incur personal legal liability for their own part in the scheme; whether they would lose their anonymity; whether they would become a target of retaliation in the workplace and subject of alienation from colleagues. There is a threat that they are will be blacklisted by the peer companies and will lose not only the current income, but also any future income in the well-paid financial sector. What happens after the whistle is blown? Nick Perry's 1998 sociological analysis¹⁵ comments that the case material indicates that the characteristic trajectory of whistle-blowers' careers is, with few exceptions, a downward spiral. There is the further prospect that this will be linked to a blame-the-victim strategy. Whistleblowing might well be classified, therefore, as a form of occupational suicide - or perhaps as accidental career death¹⁶. High reward aims to solve the basic problem that it is too expensive to an employee to guard the law.

¹⁵ Perry, N., *Indecent Exposures: Theorizing Whistle-blowing*. 19 (2) **Organization Studies** 235-257 (1998)

¹⁶ *Ibid.*

From the societal perspective, the *qui tam* allows citizens to become public prosecutors to fight corporate crime on behalf of the society as a whole. But, as De Maria comments¹⁷, whistleblowing is a complex social phenomenon. Solo acts of disclosure in the public interest -- whistleblowing -- are both pro-social and anti-social. It is good for society because it exposes wrongdoing and “it gives a battery charge to tired old democracy”, and it help establish moral heroes to follow. But whistleblowing erodes trust among work colleagues. There is no discrimination between whistleblowing and dobbing: “In our consciousness these are scrambled -- we hate doblers and we will continue to confuse them with whistle-blowers for at least another generation”¹⁸. He suggests that there is a cost as "we move from a work culture where no one would, or could disclose, to one where today's workmate could be tomorrow's informer"¹⁹.

This research, however, shows that by undermining groupthink, and cosy old schoolboy club atmosphere the *qui tam* concept serves the society in a much more efficient way. The corporations have never been mafia-style run organisations, which members plead blind allegiance to. The employees are not bound by the code of *omerta*. As multibillion fines show, the work ethic that encourages disclosure of any wrongdoing eventually proves the best way to promote loyalty to the ultimate bosses of a corporation – the shareholders, as well as to all its other stakeholders, including society as a whole.

The fact that *qui tam* is an ancient legal concept which has been evolving through twenty five centuries in different countries, cultures and jurisdictions puts particular significance to the

¹⁷ De Maria, W., (1998). *Whistleblowers Left With No More Than a Squeak*. **The Whistle** [online] available at: <http://www.bmartin.cc/dissent/contacts/au_wba/whistle199803.html > (accessed on 18 March 2012)

¹⁸ *Ibid.* [online]

¹⁹ *Ibid.* [online]

context -- whether moral, ethical, political or economic – in which the concept is analysed. Without a context the meaning of the concept becomes blurred. This distinguishing characteristic of *qui tam* predetermined the choice of the underlying methodology of this research. The conceptual framework must be flexible enough to embrace the complexity of a three-level analysis, while contemporary literature on the subject yields only its multi-fractured image. The analysis is carried out from the perspective of the law and economics, but devolved from its traditional efficiency-oriented frame of reference, preoccupied with mathematical models, which was its core in the 1970-1980s.

Economic analysis of law has evolved a lot in recent years, and its actual insights reach far beyond the theses professed by the efficiency approach initiated more than four decades ago. Law and economics has become a vast and heterogeneous discipline, reflecting several traditions, sometimes competing and sometimes complementary, including the Chicago School of Law and Economics, the New Haven School, Public Choice theory, Institutional Law and Economics, New Institutional Law and Economics and Austrian Law and Economics. The Austrian outlook is based on a traditional understanding of law, so the main assessments focus on the impact of the policy measure at issue upon the processes through which individual learning and behavioural changes take place over time²⁰. By accentuating evolution and individuals' perspective, the socially sensitive Austrian approach provides this research with a relevant framework to lead a multi-layered view of its analysis.

The rest of the research proceeds as follows.

²⁰ Crespi, G. S. *Exploring the Complicationist Gambit: an Austrian Approach to the Economic Analysis of Law*, 73 *Notre-Dame Law Review* 2 (1998), p. 16

Chapter I describes the phenomenon of *qui tam* through its millennia long evolution in the UK and the USA by putting it in historical and economic context.

Chapter II reviews the literature on *qui tam* as one of the historically most efficient and successful models of private enforcement, though a very divisive subject of academic research.

Chapter III presents a conceptual framework, based on the works applying economic methods in analysis of law, and applies the framework to explaining historical role of *qui tam*, the roots of its recent revival in the United States, and presents the contemporary analysis of *qui tam* on macro-, corporate and personal levels.

Conclusions follow.

Chapter I

Advent and Decline of *Qui Tam* Laws in Europe and Evolution of *Qui Tam* Laws in the United States

The aim of this chapter is to render the extensive description of the *qui tam* as a legal phenomenon, and present an evolution of the *qui tam* laws in England and USA within their historical and socio-economic context. Being highly context sensitive the *qui tam* legislation was shaped by the context, representing political, economical and societal change through its history. As will be shown this context is determinant of the *qui tam* evolution and forestall its development. This chapter is looking for an answer to the question, what stands behind remarkable vitality of the *qui tam*, which history exceeds 25 centuries, laying foundation for the further analysis of its recent development, present state, and possible future, carried out in the following chapters.

Qui tam is the process whereby an individual sues or prosecutes in the name of the government and shares in the proceeds of any successful litigation or settlement. The name *qui tam* is the shortened version of an abbreviated Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur*, meaning “(he) who brings an action for the king as well as for himself (in this case)”²¹. While the government may bring suit to recover losses from breach of law without cooperation from private citizens, the *qui tam* also authorises private citizens with non-public information relating to the fraud to bring suit on behalf of the

²¹ Blackstone, *supra* note 1 at 7, pp. 161-162 [online]

government. These whistle-blower²² (or *qui tam relator*) suits entitle the claimant to receive a percentage of the recovery for the government²³, that percentage varying from 10 to 30 per cent, depending upon whether or not the government itself intervenes in the suit²⁴. In some cases relators in some patent and Indian protection *qui tam* cases were entitled to half of the recovery²⁵.

A creature of antiquity – a period of history, when state institutions were embryonic and law enforcement mostly private – this practice was common in medieval England even before the dawn of the common law. Later it successfully established itself in a common law tradition.

While being close relatives, the *qui tam* legislations of these countries historically developed in different ways, having moved since mid-XIX century in precisely opposite directions. The dawn of the *qui tam* in the United States coincided with dusk of this sort of legislation in the UK. Abandoned in the UK sixty years ago *qui tam* provisions have survived in the United States. While Congress moved to supplement public enforcement with *qui tam* enforcement, the movement in England was in precisely the opposite direction: toward purely public implementation of penal statutes.

²²The Dodd-Frank Act explicitly defines whistleblower in a broader sense: “The term ‘whistleblower’ means any individual, or 2 or more individuals acting jointly, who provides information relating to a violation *of this Act to the Commission, in a manner established by rule or regulation by the Commission*” (Commodities Futures Trading Commission – CFTC, in case of Commodity whistleblower incentives and protection) or “*of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission*” (Securities and Exchange Commission – SEC, in case of Whistleblower protection in securities regulation). [Emphasis in italic added]. Noticeably, the Act denies recognition to organisations as potential whistleblowers. (The Dodd-Frank Act, *supra* note 7 at 10 [online])

²³Plus costs and attorneys’ fees

²⁴ Dodd-Frank Act in regard to the financial fraud requires the total sum of recoveries to exceed \$1mln, as a precondition of eligibility to get a reward (The Dodd-Frank Act, *supra* note 7 at 7)

²⁵ Patent and Indian protection in Doyle, Ch. Qui Tam: *The False Claims Act and Related Federal Statutes*. CRS Report to Congress -- R40785, August 6, 2009

Comparative analysis proves that these differences reflect also two different approaches to the concept of whistleblowing, the personal motives of the potential whistle-blowers, and systems of their protection and rewarding.

In the United Kingdom *Public Interest Disclosure Act 1998* makes the whistleblowing law part of the UK's employment legislation by inserting its main provisions into a new part, Part 4A, of the Employment Rights Act 1996²⁶ to protect a broad range of employees.

Part 4A explains that for the whistleblowing protection to apply the information must concern some wrongdoing (section 43B)²⁷:

(1) in this Part a "qualifying disclosure" means any disclosure of information, which, in the reasonable belief of the worker making the disclosure, is made in the public interest and tends to show one or more of the following:

(a) that a criminal offence has been committed, is being committed or is likely to be committed,

(b) that a person has failed, is failing or is likely to fail to comply with any legal obligation to which he is subject,

(c) that a miscarriage of justice has occurred, is occurring or is likely to occur,

(d) that the health or safety of any individual has been, is being or is likely to be endangered,

²⁶ The Public Concern at Work [online] available at: < <http://www.pcaw.org.uk/pida-43a-f> > (accessed on 8 September 2015)

²⁷ *Public Interest Disclosure Act 1998*, CHAPTER 23 /An Act to protect individuals who make certain disclosures of information in the public interest; to allow such individuals to bring action in respect of victimisation; and for connected purposes, [online], available at <<http://www.legislation.gov.uk/ukpga/1998/23>> (accessed on 8 September 2015)

(e) that the environment has been, is being or is likely to be damaged, or

(f) that information tending to show any matter falling within any one of the preceding paragraphs has been, is being or is likely to be deliberately concealed.

Another condition for the disclosure to qualify for the protection is that the disclosure must be made in one of more than six ways (sections 43C-43H)²⁸:

- Disclosure to employer or other responsible person
- Disclosure to legal adviser, if it is made in the course of obtaining legal advice
- Disclosure to Minister of the Crown
- Disclosure to prescribed person
- Disclosure of exceptionally serious failure
- Disclosure in other cases.

The law stipulates that it does not matter whether the person to whom the disclosure is made is already aware of the information (section 43L)²⁹.

This broad grant of protection is nevertheless limited by the requirement that the employee have acted in good faith, as the law explicitly withholds protection from whistle-blowers who act for personal gain. UK approach, at least in theory, relies on a broad, non-subject-matter based protection for whistle-blowers, which relies on moral and ethical obligations instead of bounties³⁰.

²⁸ *Ibid.*

²⁹ *Ibid.*

³⁰ Elletta Sangrey Callahan et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 *Virginia Journal of International Law* 879 (2004), p.895

The US lawmakers believe that by empowering private persons to initiate lawsuits against fraud, and guaranteeing them a portion of the government's recovery, the government is able to punish more fraud against the United States than the Department of Justice could on its own³¹. *Qui tam* suits create a significant financial incentive for whistle-blowers to come forward, and they allow the government to avoid diverting resources to litigating fraud claims that are weaker than others, but may still ultimately be successful.

Being deeply enrooted in the very fabric of American society, *qui tam* since 1986 have been enjoying renaissance due to concerted efforts set by both legislative and executive branches. Today *qui tam* lives on in federal law in four principal statutes: the False Claims Act³², Fraud Enforcement and Recovery Act³³, Patient Protection and Affordable Care Act³⁴ and Dodd-Frank Wall Street Reform and Consumer Protection Act³⁵. In two minor examples it was present in Patent Act, which Section 292 before it was amended in 2011 had been recognised as a *qui tam* statute³⁶; and Indian protection law, which Section 201 enacted in 1834, and still active, authorises *qui tam* actions for five different violations³⁷. Additionally, Deficit Reduction Act of 2005 offers a set of economic incentives to encourage every state without its own state false claims act with *qui tam* provisions to adopt one³⁸.

³¹ Davis, M.S. *The Effects of False Claims Act Whistleblowers on the Pharmaceutical Industry*. Working Paper 10-0-6612, Harvard Law School, May 2006

³²31 U.S.C. §§ 3729-3733, as amended, 2009

³³Public Law 111-21, 123 Stat. 1617-1621 (2009)

³⁴Public Law 111-148 & 111-152 (2010)

³⁵Public Law 111-203 (2010)

³⁶U.S. Patent Act, 35 U.S.C. 292, as amended, 1994 and 2011

³⁷Indian Protection, 25 U.S.C. 201, 1834

³⁸ Public Law 109-171 (2006)

What makes the scope of the *qui tam* actions in USA so broad is that although frequently punitive, it is generally, a civil procedure. Unlike antitrust laws, Racketeer Influenced and Corrupt Organizations Act³⁹ (RICO), and other federal punitive damage private attorney general provisions⁴⁰, the individual need not have been a victim of the misconduct to litigate. These same incentives that justify the government's endorsement of *qui tam* suits, however, also constitute the reasons to fear that *qui tam* suits will be abused and lead to excessive litigation. Reviled at various times throughout the ages as a breeding ground for "viperous vermin" and "parasites"⁴¹, *qui tam* nevertheless have been popular with governments for the same reason as at present times: legislative bodies have authorised it when they consider the enforcement of some law beyond the solitary capacity, or interest of law enforcement officials⁴².

The critics of American *qui tam* statutes often point out that the US legal system still relies on a British legacy, which Britain itself abandoned more than 60 years ago⁴³. The closer look at the legal and – even more significant – economic and political logic, which determined the abolishing of *qui tam* in England, however, does not provide conclusive arguments for the opponents of *qui tam*. On the contrary, it casts doubt whether historical analysis can augment the challenge to the effectiveness of *qui tam* in the contemporary United States.

Early evolution of *Qui Tam*

³⁹ 18 U.S.C. § 1961–1968

⁴¹ Coke, *supra* note 5 at 9, p.194

⁴² S. Rept. No. 77-1708, at 2 (1942), and H. Rept. No. 78-263 at 2 (1943), each quoting from a letter by Attorney General Biddle

⁴³ Beck (2000), *supra* note 4 at 8

English *qui tam* statutes had historical antecedents in Greek and Roman, and Anglo-Saxon law.

The first written evidence of what later became known as *qui tam* can be found in **ancient Greece**. As a result of the legislation by the Athenian statesman Solon (circa 640-560BC) the so-called *sukophantai* (sycophants) came into being⁴⁴. Since there was no police force in the ancient Greek states, it was a growing necessity to find ways of bringing to court those who had harmed individual citizens. Solon, arguing that “the best governed state was one in which those who were not wronged were as diligent in prosecuting criminals as those who had personally suffered”⁴⁵, ruled that for certain types of offence, “anyone who wanted to” could bring a case to court⁴⁶. Those cases offered financial rewards for a successful prosecution, but having been wise to prevent abuse Athenians established several policies intended to reduce sycophancy⁴⁷.

First, they instituted punishments – ranging from monetary fines to a prohibition on bringing additional prosecutions to full disenfranchisement – for voluntary prosecutors who failed to gather a fifth of the jurors’ votes, or dropped prosecutions before completion⁴⁸. In addition, many public suits required deposits to be paid in advance (the proceeds from public suits

⁴⁴Original meaning is “fig-revealers”. The term is conventionally transliterated as “sycophant” or “sykophant,” but the English adjective “sycophantic” derives from a later, post-classical development in the meaning of the word (Todd, S.C. (2003). *A Glossary of Athenian Legal Terms*, Demos, p.49)

⁴⁵Osborne, R. (2010). *Athens and Athenian Democracy*. Cambridge University Press, Cambridge

⁴⁶Fleck, R.K. and Hanssen, F.A. (2011). *On the Benefits and Costs of Legal Expertise: Adjudication in Ancient Athens* (online), at: <

https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&ved=0CDEQFjAD&url=https%3A%2F%2Fwww.aeaweb.org%2Faea%2F2012conference%2Fprogram%2Fretrieve.php%3Fpdfid%3D501&ei=SxOYVZjzAsHq7AbR_LKAAw&usg=AFQjCNESyh_tSAWhAlz2ZRG4rBM9Pm4xJQ&bvm=bv.96952980,d.ZGU&cad=rja
[accessed on 27 August 2014]

⁴⁷Aristotle. (2013). *The Athenian Constitution*. Start Publishing LLC

⁴⁸Bonner, R.J. (1969). *Lawyers and Litigants in Ancient Athens*. Benjamin Blom, New York, p.64

were shared with the state) – those were forfeit, if the case was lost⁴⁹. For example, claimants to property confiscated by the state were required to post one-fifth the estate's value⁵⁰.

Furthermore, citizens who believed themselves targeted by a sycophant could bring counter-suits charging prosecution without justification -- and this was used most frequently in maritime disputes⁵¹. Finally, the Assembly could charge a man directly with sycophancy, although the rules made this a rare case. The Assembly heard accusations no more than once a year, and the penalty could be applied only to three citizens and three foreign residents annually. The penalty was a fine set by a court in a separate hearing⁵².

In two centuries the sycophants became so common that even could find themselves in theatre. In Aristophanes' comedy *Wealth* (another title *Plutus*) (388BC), the sycophant became impoverished because the blind god Wealth/Plutus had his sight restored, and could finally see who deserved to be rich. He lamented his "patriotic martyrdom", claiming that, as "unofficial superintendent of all public and private affairs" he was simply "seeking to help my beloved city to the utmost of my ability"⁵³. In another Aristophanes' comedy -- *Akharnians* -- a Boiotian visitor looking for a characteristically Athenian product has a sycophant wrapped up to take home with him⁵⁴.

Aristophanes leaves no doubt about his personal attitude to the sycophants, which at first glance may be confused as a reflection of a public opinion at the time. However, given that

⁴⁹MacDowell, D.M. (1978). *The Law in Classical Athens*. Cornell University Press, Ithaca, p.239

⁵⁰Bonner (1969), *supra* note 47

⁵¹Fleck and Hanssen (2011), *supra* note 45 [online]

⁵²*Ibid.*

⁵³Andrews, A. (1981). *Greek Society*. Pelican books, p.p. 247-248

⁵⁴Fleck and Hanssen, *supra* note 45 at 20 [online]

Aristophanes in his plays expressed the views of an old-fashioned conservative⁵⁵, his depiction of the activist citizen was much closer to the feelings of the Athenian aristocracy. As Harding wrote, *sukophantai* were “a segment of society whom the wealthy despised even more than they disliked the popular juries”⁵⁶.

Together with juries, the *sukophantai* were one of two of the most fundamental pillars of Athenian democratic ideology, notably: a) the control of the law courts by the ordinary citizens, and b) the belief that every citizen not only could, but should, prosecute any infringement of the Law⁵⁷. In the absence of a police force and state prosecutors that segment of society was the true guardian of the laws. Sometimes overzealous and prosecuting for personal gain they could provoke a justifiable hostility of the wealthy. But it is telling that curtailing the power of the popular courts along with the physical elimination of the known *sukophantai* together with most prominent and radical democratic politicians were the major planks in the oligarchs’ programme at the end of the fifth, as well as in the fourth century BC in Athens⁵⁸.

The Athenian state had to maintain a justifiable balance: if the Athenians pursued sycophants too aggressively, they risked discouraging the legitimate voluntary prosecutions on which their system depended⁵⁹. Despite the opprobrium this kind of activist citizenry received from Demosthenes, who called a sycophant a man that “makes all kinds of charges and proves

⁵⁵Andrews, *supra* note 53, p. 248

⁵⁶Harding, Ph. (2015). *Athens Transformed, 404–262 BC: From Popular Sovereignty to the Dominion of Wealth*. Routledge, p.3

⁵⁷Ib., p.3

⁵⁸Ib., p.4

⁵⁹Fleck and Hanssen, *supra* note 45 at 20 [online]

none⁶⁰, the Athenians “had great difficulty in suppressing sycophants”⁶¹. Bonner pointed out, that “there are abundant indications in literature that sycophants were both numerous and formidable”⁶². The significance of the activist citizens is highlighted by the fact that the Demosthenic corpus has about 100 uses of the term *sukophantai*⁶³.

Roman criminal law relied on a system of prosecution by private citizens, known as *delatores*⁶⁴. *Delatores* or delators could be both ancient Roman prosecutors and/or informers. The role of the informer in matters of criminal law and fiscal claims was of singular importance to the maintenance of order in Roman society, which was without an adequate police force or public prosecutor before advent of Principate⁶⁵. Dominik and Hall define three roles of the *delator*: one who denounces a crime (*index*), one who witnesses (*testis*), and the prosecutor (*accusator*)⁶⁶. Unlike Ancient Athens, not much details available on how the system of *delatores* worked during earlier years of Republic. But the activist members of the society were rewarded. The later Republic encouraged *delatores* with pecuniary awards and public praise for citizens, while it could be freedom for slaves and citizenship for foreigners⁶⁷.

Beginning no later than *Lex Pedia*, which retroactively made criminals of Caesar's assassins; it became common for Roman criminal statutes to offer a portion of the defendant's property

⁶⁰Quoted in Bonner, *supra* note 47 at 20, p.64

⁶¹McDowell, *supra* at 66

⁶²Bonner (1969), *supra* note 47 at 20, p.65

⁶³Robin Osborne, *Vexatious Litigation in Classical Athens*, p.93 (in Cartledge, P. *et al.* (2003). *Nomos: Essays in Athenian Law, Politics and Society*. Cambridge University Press, Cambridge)

⁶⁴ Robinson, O.F. (1995). *Criminal Law of Ancient Rome*. Johns Hopkins University Press, Baltimore, p.100

⁶⁵Dominik, W.J. and Hall, J.C.R. (2010). *A Companion to Roman Rhetoric*. John Wiley & Sons, p.113

⁶⁶*Ibid.*

⁶⁷Encyclopaedia Britannica [online], at <<http://www.britannica.com/topic/delator>>, (accessed 12 July 2014)

as a reward for a successful prosecution.⁶⁸ Such statutes in broad sense can qualify as *qui tam* legislation because they defined an offence against the public and permitted an uninjured private party to sue for a share of a statutory forfeiture⁶⁹. As in ancient Athens, Roman Republic and later Principate adopted some measures to prevent abuse. The unsuccessful *delatores* could face punishment by *infamia* (loss of many civil rights), branding, flogging, or banishment⁷⁰. However, many unscrupulous *delatores* routinely escaped punishment, when their activities helped to augment imperial fisc in time the emperors were in need of funds⁷¹.

Two laws formed the foundation of the legal framework for *delatores* in imperial Rome -- the *Lex Papia Poppaea* and the *Lex Lulia de Maiestate* (the Law of conspiracy and the Law of treason). Created by the emperor Augustus for the good of the state they were open to different interpretations due to their vague terminology⁷². Extending the *Lex Maiestatis* to include slander against the emperor encouraged the activity of *delatores* at all levels of society, in both the imperial capital and the provinces. Tacitus wrote that "every corner of the Roman world had suffered from their attacks"⁷³. The ubiquity of *delatores* was due to the fact that prosecuting real or imaginary conspiracies against the emperor became a lucrative --

⁶⁸ S. H. Rutledge, S.H. (2001). *Imperial Inquisitions: Prosecutors and Informants from Tiberius to Domitian*. Routledge, New York, p.42

⁶⁹ Ibid.

⁷⁰ Encyclopaedia Britannica

⁷¹ Ibid.

⁷² Bunson, M. (1991). *A Dictionary of the Roman Empire*. [online], at: <
https://books.google.co.uk/books?id=HsrGEFpW80UC&pg=PA129&lpg=PA129&dq=delatores+rome&source=bl&ots=Izcvp_nNoB&sig=hp-WI-P02MazynCb2k3OrItLBe4&hl=en&sa=X&ei=5X6YVZzsMIKM7Qbo7Y-4BA&ved=0CFMQ6AEwBw#v=onepage&q=delatores%20rome&f=false>, (accessed 5 April 2014)

⁷³ Whitlark, J.A. (2014). *Resisting Empire: Rethinking the Purpose of the Letter to "the Hebrews"*. Bloomsbury Publishing, p.38

though disreputable -- profession. In the case of treason, an informer could receive a quarter of the estate while the remainder of what was confiscated went to the imperial coffers⁷⁴.

Suetonius and Tacitus wrote of the malicious *delatores* who brought false accusations in order to obtain the confiscated goods of the accused. Moreover, successful *delatores* could gain influence with those in power. Roman archives passed to the posterity the names of the most important and powerful *delatores*: Domitius Afer, Naebius Massa, and Marcus Aquilius Regulus⁷⁵. Tacitus refers to two notorious *delatores* under Vespasian – Vibius Crispus and Eprius Marcellus – as “friends of Caesar”⁷⁶. The wealth and status that came from informing enabled people to circumvent the typical avenues of promotion, and informants were routinely depicted as those arising from the dregs of society, including slaves and freedmen motivated by the desire for money, status, political influence, or self-preservation.

Rutledge, however, draws a more complicated picture of the Roman public prosecutors. In his view, the *delatores* and *accusatores* were reflective of enduring cultural and political values of the Roman society, and often their motives would have been perfectly understood by Cicero and his republican counterparts⁷⁷ at the end of the Republic. In *De Officiis* Cicero advocated the acts of citizens prosecuting the wrong doings, but in his opinion, they should act only “in the interest of the state... or to avenge wrongs... or for the protection of our provincials”⁷⁸, and “this sort of work... may be done once in a lifetime or at all events not often”⁷⁹. Cicero concludes by emphasising the moral dimension of the prosecutorial activities

⁷⁴ Ibid., p.39

⁷⁵ Dominik and Hall, *supra* note 65 at 27, p.114

⁷⁶ Whitlark, *supra* note 73 at 28, p.41

⁷⁷ Rutledge, *supra* note 68 at 28, p.3

⁷⁸ Marcus Tullius Cicero, *De Officiis*, Book II (“Expediency”), ii.50 [online] at <<http://www.gutenberg.org/files/47001/47001-h/47001-h.htm>>, (accessed on 8 April 2015)

⁷⁹ Ibid.

of the members of public: “But if it shall be required of anyone to conduct more frequent prosecutions, let him do it as a service to his country; for it is no disgrace to be often employed in the prosecution of her enemies. And yet a limit should be set even to that. For it requires a heartless man, it seems, or rather one who is well nigh inhuman, to be arraigning one person after another on capital charges”⁸⁰.

From the point of view of a famed statesman of the Republic, there was nothing inherently inappropriate in such acts. It was the transformation of the Roman state from republic to empire that brought crucial changes to the political and legal structure under which prosecutors worked. And it was the shift to an autocratic form of government, new repressive laws and the makeup of the courts that facilitated the activities of *delatores*, turning them into the instruments of the repressive rule of one man during the early Principate⁸¹.

Delatores and *accusatores* were important part of the Roman imperial machinery on its early stages of development. But after Flavians ascended to the throne in 69 AD, the means of state control and intelligence gathering gradually improved. As Bunson wrote, “the dangerous *speculatorers* of the guard, the agents, spies and killers of the Praetorian ranks” serving as one of the early Roman intelligence units, and later far larger and better organised *prumentarii* “rendered the concept of the *delatores* obsolete”⁸². During the years of later Principate with the Roman bureaucracy at its zenith all informers were paid by the government, “dependent upon imperial spy masters for their wages”⁸³. Although it was not until the end of the IV century, that the legislation for *accusatores* ceased to exist. It was

⁸⁰ *Ibid.*

⁸¹ Rutledge, *supra* note 68 at 28, p.9

⁸² Bunson, *supra* note 72 at 28, p.129

⁸³ *Ibid.*

abolished by the emperor Theodosius I the Great, who proclaimed Nicene Christianity the state religion, outlawed all Hellenistic rituals and customs, and significantly changed imperial laws⁸⁴.

An example of private *qui tam* enforcement can also be found in **Anglo-Saxon England**.⁸⁵ In 695 A.D., Withered, King of Kent, issued a law prohibiting labour on the Sabbath, which included the following *qui tam* enforcement provision: "If a freeman works during the forbidden time [between sunset on Saturday evening and sunset on Sunday evening], he shall forfeit his *healsfang*⁸⁶, and the man who informs against him shall have half the fine, and [the profits arising from] the labour"⁸⁷. This Anglo-Saxon provision foreshadowed subsequent developments in English law, as the backlash against obnoxious conduct of informers enforcing the Sunday closing laws 1250 years later helped generate the political consensus for England's elimination of *qui tam* legislation⁸⁸.

Historically *qui tam* closely related to the bounty hunting. In **early medieval Europe** the nascent states had little or no institutions to back the interests of their sovereigns. The early monarchies offered bounties to enlist the services of influential subjects. In case a subject was instrumental in defeat and capture of the adversary the sovereign would give a loyal subject the titles and part of the income producing lands, which previously were held by the

⁸⁴ Gibbon, E. (1998). *The History of the Decline and Fall of the Roman Empire*. Wordsworth Editions Ltd, Hertfordshire, Ch.25, p.p.556-580

⁸⁵ Plucknett, T.F.T. (1960). *Edward I and Criminal Law*. Cambridge University Press, Cambridge

⁸⁶ *Healsfang/Halsfang* was a fine to avoid punishment (Black's Law Dictionary)

⁸⁷ Attenborough, F.L. (2013). *The Laws of the Earliest English Kings*, HardPress Publishing. Reprint of Frederick Levi Attenborough. (1922). *The Laws of the Earliest English Kings*, The Lawbook Exchange, New Jersey, p.27

⁸⁸ Beck (2000), *supra* note 4 at 8, p.567

vanquished opponent⁸⁹. This tradition was still alive by the time of American Revolution – veterans of the American revolutionary war were entitled to land grants for their service⁹⁰.

In the early democracy of ancient **Iceland** there was no government authority with prosecution and punishment functions – prosecution was private. The *Hrafnkels saga*⁹¹ describes in detail the private nature of criminal prosecution and execution of judgements in that island in medieval times. The convicted criminals forfeited their property to the prosecutor. In order to raise support for the prosecution, the prosecutor offered share of the criminal's property to the prosecutor's supporters in the prosecution⁹².

Remarkably, the *qui tam* prosecution precedes the simpler bounty system, when information about breach of law is traded for a reward. The ability to serve as an ancillary to the state institutions, and even as their substitution, preserves *qui tam* as a convenient law enforcement option available to the state at any given stage of its evolution through history. Rise, decline and new dawn of *qui tam* in England provide a clue to understanding its vital strength as a law enforcement mechanism.

The Rise and Decline of *Qui Tam* Laws in England

⁸⁹ Fisher, J. *et al. Privatizing Regulation: Whistleblowing and Bounty Hunting in the Financial Services Industries*, 19 **Dickinson Journal of International Law** 117 (2000-2001), p.137

⁹⁰ New York State Archives: Applications for Land Grants, "Land papers, 1st Series", 1642-1803, vol. 37-3

⁹¹ John Tucker (Ed.), (1989). *Sagas of the Icelanders: A Book of Essays*. Garland, New York

⁹² Icelandic Saga Database [online], at <http://sagadb.org/hrafnkels_saga_freysgoda.en>, (accessed on 20 June 2015)

In England even before the Magna Carta, common law *qui tam* provided an efficient way to pursue fraud without government prosecutors⁹³. In addition, private citizens valued *qui tam* more because it allowed them access to royal courts⁹⁴. The steep rise of *qui tam* enforcement began in earnest 250 years after the Norman Conquest.⁹⁵ Legislation important to the national sovereign was not always a high priority to local officials; in fact, enforcement of national law was particularly difficult when such national legislation undermined local officials' interests. Faced with limited public enforcement resources and the difficulty of implementing national policies over numerous, geographically separated, local jurisdictions, Parliament began during the fourteenth century to turn increasingly to *qui tam* enforcement as the most practical means to police compliance with regulatory requirements⁹⁶.

The 1318 Statute of York,⁹⁷ an early English *qui tam* provision, demonstrates the potential for conflict between national policies and local interests. The legislation related to the "assizes of wine and victuals," which required uniform prices for certain consumer goods, set by reference to established criteria⁹⁸. Parliament was concerned that enthusiasm for enforcing the price restrictions could wane if local officials were themselves selling the regulated commodities. The Statute of York prohibited such trade⁹⁹.

This prohibition on sale of regulated commodities by officials could have its intended effect only if the threat of forfeiture was supported by a high probability of enforcement. The King

⁹³Boese, J.T. (2011). *Civil False Claims and Qui Tam Actions*. 4th ed., Wolters Kluwer Law & Business – Aspen Publishers, New York, pp.1-8

⁹⁴ *Ibid.*

⁹⁵ Plucknett (1960), *supra* note 84 at 27

⁹⁶ Beck (2000), *supra* note 4 at 8, p.567

⁹⁷ Attenborough (2013), *supra* note 86 at 27

⁹⁸ Lipson, E. (1959). *The Economic History of England*. A. and C. Black

⁹⁹ *Ibid.*, p. 58

did not have an extensive network of paid royal officials whose loyalty to the interests of the Crown could be assumed¹⁰⁰. The question, therefore, was how to assure that city and borough officers would take seriously the threat of forfeiture posed by the statute. Parliament's solution was to permit *qui tam* enforcement of the penalty: "[T]he third Part [of the forfeited merchandise] shall be delivered to the Party that sued the Offender, as the King's Gift. And in such Case he that will sue [for a thing so forfeited,] shall be received¹⁰¹.

Concerns about local under-enforcement of national regulations explain a 1331 *qui tam* statute¹⁰² that was intended to enforce a provision of the 1328 Statute of Northampton regulating the length of fairs¹⁰³, and two Statutes of Labourers, enacted in 1349¹⁰⁴ and 1350¹⁰⁵. The statutes allowed informers to seek forfeitures from a town mayor or a bailiff, who failed to enforce the regulations issued by Parliament¹⁰⁶.

Over the next 150 years, "what began as a trickle of *qui tam* statutes gradually became a flood"¹⁰⁷. The majority of these enactments regulated economic activities in a wide array of industries¹⁰⁸. *Qui tam* provisions, for instance, could be found in a 1381 statute, that regulated the price of wine¹⁰⁹, a 1416 statute¹¹⁰ prohibiting "patenmakers" from using the timber "aspe"

¹⁰⁰ Beck (2000), *supra* note 4 at 8, p.568

¹⁰¹ Attenborough, *supra*, p.355

¹⁰² 5Edw. 3, ch. 5 (1331) (Eng.) [online] available at: <<http://www.legislation.gov.uk/>> (accessed on 9 August 2011)

¹⁰³ 2 Edw. 3, ch. 15 (1328) (Eng.), *supra* 62

¹⁰⁴ Statute of Labourers, 23 Edw. 3 (1349) (Eng.), *supra* 62

¹⁰⁵ Statute of Labourers, 25 Edw. 3 (1350) (Eng.), *supra* 62

¹⁰⁶ *Id.*

¹⁰⁷ Beck (2000), *supra* note 4 at 8, p.577

¹⁰⁸ Of particular interest is a 1455 statute addressing an oversupply of lawyers in the city of Norwich and the counties of Norfolk and Suffolk. See 34 Hen.6, ch.7 (1455) (Eng.) [online] available at: <<http://www.legislation.gov.uk/>> (accessed on 9 August 2011)

¹⁰⁹ Rich.2, ch.4 (1381) (Eng.) *supra* 68

¹¹⁰ 4 Hen.5, ch.3 (1416) (Eng.) *supra* 68

in making "patens" or "clogs"¹¹¹, and a 1423 statute providing for forfeiture of defectively tanned leather and prohibiting "cordwainers" from acting as tanners¹¹². Numerous other *qui tam* statutes touched upon a wide variety of British commercial activities¹¹³.

In addition to many statutes regulating economic affairs, a number of *qui tam* statutes enforced non-economic social regulations¹¹⁴. The use of *qui tam* provisions to regulate the performance of public servants became increasingly common in the fourteenth and fifteenth centuries. In 1360, Parliament enforced what in contemporary parlance could be named an anticorruption regulation, by permitting informers to sue jurors who accepted bribes¹¹⁵. Shortly thereafter, another law authorised *qui tam* suits if a person responsible for procuring and arranging for carriage of provisions for the King's household accepted a bribe¹¹⁶. A 1391 statute permitted suits against mayors, sheriffs, and bailiffs who failed to implement a rule concerning measurement of grain¹¹⁷. A 1442 statute prohibited customs officials and other public employees from engaging in businesses related to their public duties¹¹⁸. The value of *qui tam* suits as a check on public officials had become so well accepted by 1444 that Parliament adopted no fewer than five such statutes in that single year¹¹⁹.

¹¹¹ Wooden-soled shoes (Beck (2000), *supra* note 4 at 8, p.578)

¹¹² 2 Hen. 6, ch. 7 (1423) (Eng.) *supra* 68

¹¹³ One could find over 20 such statutes, enacted between 1420 and 1465 (Lipson, *supra* note 97 at 29, p.133)

¹¹⁴ 7 Hen.4, ch.14 (1405) (Eng.) (restricting the granting of liveries). 80 years later another statute sought to keep commoners in their place by permitting wealthy landowners to seize swans in the possession of those with incomes below specified levels (22 Edw.4, ch.6 (1482) (Eng.) A 1477 statute permitted *qui tam* suits against those playing the games of "clossh, kailes, half-bowl, hand in and hand out, and queckboard," or permitting those games to be played on their property (17 Edw.4, ch.3 (1477) (Eng.) *supra* 68

¹¹⁵ 34 Edw.3, ch.8 (1360) (Eng.) *supra* 68

¹¹⁶ 36 Edw.3, ch.3 (1362) (Eng.) *supra* 68

¹¹⁷ 15 Rich.2, ch.4 (1391) (Eng.) *supra* 68

¹¹⁸ 20 Hen.6, ch.5 (1442) (Eng.) *supra* 68

¹¹⁹ Beck (2000), *supra* note 4 at 8, p. 573

By the sixteenth century, *qui tam* statutes had become a common feature of English law¹²⁰. They brought with them, however, unintended consequences. They gave rise to a class of bounty hunters who unscrupulously exploited weaknesses in the system: “Old statutes which had been forgotten were unearthed and used as means to gratify ill-will. Litigation was stirred up simply in order that the informer might compound for a sum of money. Threats to sue were easy means of levying blackmail.”¹²¹

Edward Coke in his *Third Part of the Institutes of the Laws of England*, originally published posthumously in 1644, devotes a chapter to the reform legislation designed to control the practices of these “vexatious relators, informers, and promoters,” whom he classifies as *turbidum hominum genus*¹²² and as a species among the classes of “viperous vermin”¹²³ -- a class was so unpopular that Queen Elizabeth I found it necessary to issue a proclamation shielding its members from mob violence.¹²⁴ Legislative reform (*An Act to redress Disorders in common Informers*¹²⁵, and some other statutes and royal proclamations¹²⁶), however, appears to have been effective, because more than a hundred years after Coke’s comments, in XVIII century, Sir William Blackstone described *qui tam* without criticism, expect to note a statutorily-cured abuse¹²⁷.

¹²⁰ Doyle (2009), *supra* note 24 at 15

¹²¹ Coke, *supra* note 5 at 9, p.192

¹²² The term, which describes a species of lawless men who disrupt the normal peace and order of society, can be alternatively translated as, “a wild or disorderly class of men” (Beck (2000), *supra* note 4 at 8, p.616)

¹²³ Coke, *supra*, p.194

¹²⁴ Doyle (2009), *supra* note 24 at 15, p.9

¹²⁵ *18 Eliz.* in Henry Fielding, Malvin R. Zirker (1988). *An Enquiry Into the Causes of the Late Increase of Robbers and Related Writings*. Clarendon Press, p.152

¹²⁶ See Chapter II, p.

¹²⁷ Blackstone, *supra* note 1 at 7, pp. 161-162 [online]

Blackstone's *Commentaries on the Laws of England*, written in 1765-1769, provides significant contribution to the legal concept of *qui tam*. He addressed *qui tam* actions in the course of discussing the law of contracts. In Blackstone's view, it was from the fundamental *social contract*, that the obligation to obey a penal statute derived¹²⁸. The person who violated a penal statute was "bound by the fundamental contract of society to obey the directions of the legislature, and pay the forfeiture incurred to such persons as the law requires"¹²⁹.

Blackstone's discussion suggests the following criteria by which to identify a *qui tam* statute¹³⁰:

- The statute defines an offense against the sovereign or proscribes conduct contrary to the interests of the public;
- A penalty or forfeiture is imposed for violation of the statute;
- The statute permits a civil or criminal enforcement action pursued by a private party;
- The private informer need not be aggrieved and may initiate the action in the absence of any distinct, personal injury arising from the challenged conduct;
- A successful informer is entitled to a private benefit consisting of part or all of the penalty exacted from the defendant;
- The outcome of the private informer's enforcement action is binding on the government.

¹²⁸ *Ibid.*, p.162

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*, pp.161-162

While many types of legislation exhibit some of these characteristics, the combination of all these features serves to distinguish a *qui tam* statute from other models of statutory enforcement¹³¹.

In XVIII-early XIX centuries *qui tam* legislation remained popular aimed at supporting regulation of various economic activities. During reign of George II and George III more than 20 such *qui tam* laws were enacted¹³². It is worth mentioning, that in XVIII century Parliament actively enacted *qui tam* statutes relating to religious beliefs (targeting Catholics, but also dissenting Protestants as well as all others not zealous enough to exercise their religious duties)¹³³ and excessive consumption of alcohol¹³⁴ (the latter was one of the most hated, provoking recurring riots and numerous violent attacks on informers)¹³⁵. From this moment the tide of popularity of *qui tam* activities turned on descent¹³⁶.

The period extending from the last quarter of the XVII century to the beginning of the XIX century was prosperous as British entrepreneurs extended the range of their business around the globe. By the 1720s Britain was one of the most prosperous countries in the world¹³⁷. Economic might pre-determined the vast geography and success of military activities abroad.

In XVIII century Britain was involved in over 100 wars with the most significant such as War of the Spanish Succession, Carnatic wars in India, the Seven Year War, American War on

¹³¹ Beck (2000), *supra* note 4 at 8, p.553

¹³² Lipson, *supra* note 97 at 29, p.353

¹³³ One of the most remarkable examples is the Sunday Observance Act, 21 Geo.3, ch.49 (1781) (Eng.) [online] *supra* 68

¹³⁴ 9 Geo.2, ch.23, §1 (1736) (Eng.) *supra* 68

¹³⁵ Beck (2000), *supra* note 4 at 8, pp.598-601

¹³⁶ Doyle (2009), *supra* note 24 at 15, p.19

¹³⁷ Kennedy, P. (1989). *The Rise and Fall of the Great Powers*, Vintage, pp. 80–84

Independence, and above all the Napoleonic wars. The rising costs associated with warfare had a profound impact on the government financing forcing it to shift from the income from royal agricultural estates and special imposts and taxes to reliance on customs and excise taxes. In 1790 an income tax was introduced for the first time. The rise in taxes amounted to 20% of national income¹³⁸, but the demand from the state for more war supplies stimulated the industrial sector, paving the road of Industrial revolution.

The industrial revolution transformed the XIX century Britain. In 1801, at the time of the first census, only about 20% of the population lived in towns¹³⁹. By 1851 the figure had risen to over 50%. By 1881 about two thirds of the population lived in towns¹⁴⁰. Economic and social changes were followed by the expansion of the government, establishing state bureaucracy as a linchpin of an empire.

With the expansion of the government reliance on *qui tam* legislation declined dramatically as a result of the development of alternate means of law enforcement. By the late nineteenth century, Parliament's enthusiasm for *qui tam* statutes had cooled significantly. Only twelve *qui tam* statutes had been enacted between 1825 and 1895¹⁴¹. Only one *qui tam* statute was adopted in the twentieth century -- directed at police officers who interfered with voting for local offices¹⁴² -- and this was merely a re-codification of a nineteenth century enactment.¹⁴³

¹³⁸ Robert M. Kozub, "Evolution of Taxation in England, 1700–1850: A Period of War and Industrialization," 32 (2) **Journal of European Economic History** 363–388 (2003)

¹³⁹ *Ibid*

¹⁴⁰ *Ibid*

¹⁴¹ Deutsch, C., *Restoring Truth: An Argument to Remove the Qui Tam Provision from the False Marking Statute of the Patent Act*, 11(2) **Minnesota Journal of Law, Science and Technology** 829 (2010), p.832

¹⁴² The Representation of the People Act, 12 & 13 Geo.6, ch.58, §87 (1949) (Eng.) *supra* 68

¹⁴³ County and Borough Police Act, 22 & 23 Vict., ch.32, §3 (1859) (Eng.) *supra* 68

The decline of *qui tam* enforcement coincided with the development of modern police departments and the proliferation of public prosecutors. A decade after Parliament created a permanent police force for the city of London in 1829¹⁴⁴, it enacted Metropolitan Police Courts Act sought to restrict the activities of common informers¹⁴⁵. The abolishing of *qui tam* after that was not very much surprising.

There were three main reasons, which led to the repealing *qui tam* at the time.

First, In England the *qui tam* doctrine was initially instituted as a legal adjunct to supplement country's insufficient legal machinery in order to bring more offenses to the cognizance of the courts¹⁴⁶. Informers might have been necessary at an earlier time in English history. It was not until 1856 that all areas of the country had a police force¹⁴⁷. When the administrative machinery of the state was weak to secure law enforcement, this field of activity had to be left in the hands of private enterprise¹⁴⁸. It was necessary that there should be some incentive and the common informer had to be able to obtain substantial financial inducement to carry out the important social work of seeing that the law was maintained¹⁴⁹. The rise of law enforcement, both quantitative and qualitative, made that private enterprise function redundant.

¹⁴⁴ 10 Geo.4, ch.44 (1829) (Eng.) *supra* 68

¹⁴⁵ 2 & 3 Vict., ch.71 (1839) (Eng.) *supra* 68

¹⁴⁶ Pitzer, D.D. *The Qui Tam Doctrine: A Comparative Analysis of Its Application in the United States and the British Commonwealth*. 7 **Texas International Law Journal** 415 (1972)

¹⁴⁷ Beck (2000), *supra* note 4 at 8

¹⁴⁸ 483 Parl. Deb., H.C. (5th ser.) 2159 (1951) (statement of Mr MacColl)

¹⁴⁹ *Id.* at 2160 (statement of Mr MacColl)

Second, Sir John Fielding, a magistrate who presided over an early police force in London¹⁵⁰, believed that the rewards offered to informers had the perverse effect of discouraging public-spirited citizens from reporting evidence of crimes¹⁵¹. From the point of view of the majority lawmakers at the time of abolishing the *qui tam* laws (year 1951), the *qui tam* informer undermined the coherence and homogeneity of the British society. The informer was berated for lacking public spiritedness, because he demanded a reward to perform the duty of every citizen¹⁵². Moreover, "he is unconcerned about the public interest, and he is actuated purely by mercenary motives and his own cupidity¹⁵³. Majority view was that it was wrong for a free country to allow informers to seek redress for their own pecuniary advantage in respect of a public wrong in which they had no direct personal interest or concern; a wrongdoing to the State should surely be atoned for by a penalty payable to the State alone¹⁵⁴.

Third, *qui tam* legal principles provoked legal conflict with Scotland, for the reason Scottish legal system did not recognise common informer procedure before Union of Parliaments¹⁵⁵.

The occasion that caused abolishing of *qui tam* appeared on the 100th anniversary of the Great Exhibition of 1851. The UK Government began planning years in advance for a huge event -- the "Festival of Britain, 1951." The event would have its serious side, but there would also be "amusements" of a less educational nature¹⁵⁶. As plans for the Festival solidified, the

¹⁵⁰ Fielding, J. and Fielding, H. (1768). *Extracts from Such of the Penal Laws: As Particularly Relate to the Peace and Good Order of this Metropolis with Observations for the Better Execution of Some and on the Defects of Others; to which are Added the Felonies Made So by Statute, Some General Cautions to Shopkeepers and a Short Treatise on the Office of Constable*. Gale Ecco, Print Editions, 2010, United States, pp.43-44

¹⁵¹ 293 Parl. Deb., H.C. (5th ser.) 189 (1934) (statement of Mr. Hurst)

¹⁵² 483 Parl. Deb., H.C. (5th ser.) 2087 (1951) (statement of Mr. Heald)

¹⁵³ 483 Parl. Deb., H.C. (5th Ser.) 2099 (1951) (statement of Mr. Hughes)

¹⁵⁴ 171 Parl. Deb., H.L. (5th ser.) 1052 (1951) (statement of Viscount Simon)

¹⁵⁵ Beck (2000), *supra* note 4 at 8, p.606

¹⁵⁶ Festival of Britain (Sunday Opening) Act, 14 & 15 Geo.6, ch.14 (1951) (Eng.)

concern arose that if the Festival were open on Sundays, some informer might sue government organisers or private parties participating in the entertaining events¹⁵⁷. The precise application of the eighteenth century Sunday Observance Act was unpredictable in the twentieth century, and the Government introduced a Sunday Openings Bill to exempt the Festival from the Sunday observance statutes and to specify the permissible scope of the Festival's Sunday exhibitions¹⁵⁸. Shortly before debate on the Sunday Opening Act, the Common Informers Act of 1951 was introduced as the primary legislative vehicle for abolition of England's remaining *qui tam* statutes, which were expressly characterised as anachronism¹⁵⁹. By the overwhelming majority two bills were enacted by the Parliament.

It would be inaccurate though to state that *qui tam* has left Britain, and the page in its history in the UK has been turned over. In October 2013 the Secretary of State for the Home Department presented to the Parliament *Serious and Organised Crime Strategy*, on behalf of HM Government. Introducing it the Home Secretary pointed out that serious and organised crime was a threat to the UK national security, and cost the UK more than £24 billion a year¹⁶⁰. The Strategy accepts that "for too long, too many serious and organised criminals have been

¹⁵⁷ 481 Parl. Deb., H.C. (5th ser.) 539-74 (1950) (debating a bill to permit the Festival to remain open on Sundays despite the Sunday Observance Act)

¹⁵⁸ *Supra* 68, §1(b)

¹⁵⁹ The Lord President of the Council, having described the Sunday observance laws as "incredibly obsolete and obscure," considered it "a further embarrassment" that "the main instrument of enforcement of the law is the common informer." 481 Parl. Deb., H.C. (5th ser.) 539 (1950) (statement of The Lord President of the Council). Another Member of Parliament found it "very wrong that the activities of the common informer should still be encouraged by some of the archaic legislation that is still on the Statute Book." *Id.* at 549 (statement of Mr. Butler). Another commented that "[t]he common informer is odious, I think, to most Englishmen." *Id.* at 568 (statement of Mr. Hale)

¹⁶⁰ *Serious and Organised Crime Strategy*. HM Government, October 2013 [online], available at: < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/248645/Serious_and_Organised_Crime_Strategy.pdf > (accessed on 19 September 2015), p. 5

able to remain one step ahead and out of law enforcement's reach"¹⁶¹, calling for "a new response"¹⁶².

One of such new responses the Strategy identifies is a *qui tam*¹⁶³. In section "PROTECT: Increasing protection against serious and organised crime" the government put forward a plan of action:

6.44 We need to not only target serious and organised criminals but also support those who seek to help us identify and disrupt serious and organised criminality. In July, we announced a review of the support that is available to those who report suspected illegal activity. BIS, the Ministry of Justice and the Home Office will consider the case for incentivising whistle blowing, including the provision of financial incentives to support whistle blowing in cases of fraud, bribery and corruption. As part of this work we will examine what lessons can be drawn from the successful 'Qui Tam' provisions in the US where individuals who whistle-blow and work with prosecutors and law enforcement can receive a share of financial penalties levied against a company guilty of fraud against the government¹⁶⁴.

The examination has brought no visible results so far, but the trend towards more role for the private enforcement in the UK has become more salient after a new legislation came into force on 1 October 2015 allowing US-style class actions lawsuits in case a competition law has been breached¹⁶⁵. Under the Consumer Rights Act 2015 companies, which are found to have broken anti-trust law in Europe, may also be liable for millions of pounds in compensation.

¹⁶¹ *Ibid.*

¹⁶² *Ibid.*

¹⁶³ Remarkably how the government defines the *qui tam*: "Qui Tam is the common description for the US False Claims Act which is regarded by the US Government as a vital tool for combating fraud against the federal government. The False Claims Act contains 'qui tam' provisions that allow private citizens to sue, on the government's behalf, companies and individuals that were defrauding the government". *Serious and Organised Crime Strategy, supra* note 160 at 38, p.61

¹⁶⁴ *Ibid.*, p.61

¹⁶⁵ Consumer Rights Act 2015 [online], available at: < <http://www.legislation.gov.uk/ukpga/2015/15/contents/enacted> > (accessed on 19 September 2015)

Amending a Competition Act 1998, the new legislation permits “collective proceedings”, combining “two or more claims” meaning that damages can add up quickly¹⁶⁶.

The class actions stand as the most powerful and prevalent model of private enforcement in the United States, comprising with two other models – *qui tam* and citizens’ suit – three main pillars of the private justice in America¹⁶⁷.

When set into historical context *qui tam* reveals correlation with the expansion of the English and UK government, both in terms of state bureaucracy and its financial might. The more power state bureaucracy accrues, the less it relies on private initiative in law enforcement, as bureaucracy values tend to favour predictability, control, and administrative ease. However, when the government finds itself squeezed financially, as did the UK government after the recent financial crisis, it turned to a *qui tam* model as a useful tool. As correlation does not necessarily imply causation, the hypothesis that financial and administrative might somehow connected to the expansion or diminishing of *qui tam* will be tried within another historical context – in America.

Early American Experience

Qui tam was no stranger to US legal system derived from the British one. Nurtured over the several centuries the *qui tam* laws were considered to be such a vital element of good governance that they were among the earliest laws enacted by the colonial legislatures prior

¹⁶⁶ *Ibid.*, Schedule 8 “Private Actions in Competition Law”

¹⁶⁷ Bucy (2003), *infra* note 450 at 106

to the revolution¹⁶⁸. Colonial courts heard *qui tam* cases arising under those statutes¹⁶⁹, as well as under English law¹⁷⁰. Some of the earliest recorded *qui tam* actions in published United States case law occurred during the year of the drafting of the United States Constitution and three years before the first sitting of the Supreme Court. In 1787, the Pennsylvania Supreme Court heard the case of *Phile qui tam v. The Ship Anna*¹⁷¹, in which an informer brought a case against a ship owner for beer brought into the state without being recorded on the ship's manifest and without the proper dues being paid to the state, in violation of state law. Furthermore, in *Musgrove qui tam v. Gibbs*¹⁷², the Pennsylvania Supreme Court ruled on a usury violation, which deprived the state of penalties under the usury statute. Later *qui tam* cases routinely appeared among the cases of the early federal courts¹⁷³.

¹⁶⁸ 1 **Statutes of Connecticut** 531 (1672) (penalties of 10 shillings for permitting a night-time disorderly assembly under one's roof to be distributed half to the town and half to the individual who filed the complaint); **Colonial Laws of Massachusetts** 8 (1686) (penalties for fraud in the sale of bread to be distributed one-third to inspector who discovered the fraud and remainder for the benefit of the town where the offense occurred); *Id.* at 54 (penalties for catching mackerel out of season to be distributed one half to the informer and one half to the town where the offense occurred); 1 **Colonial Laws of New York**, 1664-1719, 279, 281 (1692) (penalty of £50 for an officer's failure to perform duties for the prevention of piracy to be distributed one moiety to the informer and one to the province); *Id.* at 845 (1715) (20 shilling penalties for taking oysters out of season to be distributed half to the informer and half to the benefit of the poor of the town where the offense occurred); 2 **Colonial Laws of New York**, 1720-1737, 988, 989-90 (1737) (penalties of £30 for peddling without a license to be distributed one moiety to the informer and one for the benefit of the town where the offense occurred); 7 **Virginia Statutes** (Henning) 282, 285 (1759) (penalties for peddling without a license to be distributed one moiety to the king for the support of the College of William & Mary and one to informer who brings the action on the debt for its recovery); IV **Statutes of South Carolina**, 1752-1786, 460 (1778) (penalties of £1,000 for acting as a magistrate without authorisation to be distributed one half to the public treasury and one half to those who sued for their recover)

¹⁶⁹ *Churchill v. Blackburn*, 1 Va. Colonial Dec. R26 (Va. Gen. Ct. 1730); *Musgrove, qui tam v. Gibbs*, 1 U.S. 216 (Pa. 1787)

¹⁷⁰ *Britton, qui tam v. Ridgely*, 4 H. & McH. 503 (Md. Prov. 1768) (3 & 4 GEORGE II, ch.12); *Anderson, qui tam v. Winston*, 2 Va. Colonial Dec. B201 (Va. Gen. Ct. 1735) (32 HENRY VIII, ch.9). 17 *E.g.*, section 3, Act of March 1, 1790, 1 Stat. 101, 102 (1790); section 4, Act of July 20, 1790, 1 Stat. 131, 133 (1790); section 3, Act of July 22, 1790, 1 Stat. 137, 138 (1790); section 44, Act of March 2, 1791, 1 Stat. 198, 209 (1791)

¹⁷¹ *United States ex rel. Stevens v. Vermont Agency of Natural Resources*, 162 F.3d 195, 202 (2d Cir. 1998), *cert. granted*, 11g S. Ct. 2391 (iggg)

¹⁷² 1 U.S. 197, 1 Dall. 197, 1 L.Ed. 98 (1787)

¹⁷³ *United States v. Simms*, 5 U.S. (1 Cranch) 252 (1803); *Adams v. Woods*, 6 U.S. (2 Cranch) 336 (1805); *The Emulous*, 1 F.Cas. 697 (D. Mass. 1813)(No. 4,479), *revised sub nom.*, *Brown v. United States*, 12 U.S. (8 Cranch) 110 (1814)

It will be contrary to the historical facts to assume that the framers of American Constitution were not familiar with *qui tam* legislation. Immediately after enacting the Constitution, the First Congress employed *qui tam* actions in various forms and contexts. Six statutes imposed penalties and/or forfeitures for conduct injurious to the general public and expressly authorised suits by private informers, with the recovery being shared between the informer and the United States¹⁷⁴. Three statutes by similarly imposing penalties and/or forfeitures for conduct injurious to the general public, authorised informers bringing successful prosecutions to keep the entire recovery¹⁷⁵. Two other *qui tam* statutes imposed penalties and/or forfeitures for conduct injurious both to the general public and more concretely to a subclass thereof. One allowed any person to sue¹⁷⁶, and the other allowed suits by anyone whose private rights were violated¹⁷⁷.

As Sylvia (2010)¹⁷⁸ pointed out: “[I]n the early years of the Nation, the *qui tam* mechanism served a need at a time when federal and state governments were fairly small and unable to devote significant resources to law enforcement. As the role of the Government expanded, the utility of private assistance in law enforcement did not diminish. If anything, changes in the role and size of Government created a greater role for this method of law enforcement”.

¹⁷⁴ Act of Mar. 1, 1790, ch.2, §3, 1 Stat. 101, 102 (marshals' misfeasance in census-taking); Act of July 5, 1790, ch.25, §1, 1 Stat. 129 (same); Act of July 20, 1790, ch.29, §4, 1 Stat. 131, 133 (harbouring runaway mariners); Act of July 22, 1790, ch.33, §3, 1 Stat. 137, 137-38 (unlicensed Indian trade); Act of Feb. 25, 1791, ch.10, §§8, 9, 1 Stat. 191, 195-96 (unlawful trades or loans by Bank of United States subscribers); Act of Mar. 3, 1791, ch.15, §44, 1 Stat. 199, 209 (avoidance of liquor import duties)

¹⁷⁵ Act of July 31, 1789, ch.5, § 29, 1 Stat. 29, 44-45 (import duty collectors' failure to post accurate rates); Act of Sept. 1, 1789, ch.11, § 21, 1 Stat. 55, 60 (failure to register vessels properly); Act of Aug. 4, 1790, ch.35, § 55, 1 Stat. 145, 173 (import duty collectors' failure to post accurate rates)

¹⁷⁶ Act of July 20, 1790, ch.29, §1, 1 Stat. 131, 131 (failure of vessel commander to contract with mariners)

¹⁷⁷ Act of May 31, 1790, ch.15, §2, 1 Stat. 124, 124-25 (copyright infringement)

¹⁷⁸ Sylvia, Claire M., (2010). *The False Claims Act: Fraud Against the Government*, 2nd ed., Thomson West, Rochester, N.Y, §2:6, p.41

A birth of the False Claims Act in the middle of the American Civil War serves as a perfect example of how insightful is this conclusion.

Birth of the False Claims Act

The circumstances under which a False Claims Act was adopted point to the main condition that makes qui tam valuable to the government – inability of its administration to prosecute fraud and provide for the proper level of deterrence.

The Civil War prompted Congress to enact the original False Claims Act in 1863. As government spending on war materials increased, government contractors took advantage of opportunities to squeeze money out of the United States government. “Through haste, carelessness, or criminal collusion, the state and federal officers accepted almost every offer and paid almost any price for the commodities, regardless of character, quality, or quantity.”¹⁷⁹ The Act¹⁸⁰ was directed against government contractors, who, in short, falsely made fraudulent claims for payment by the government, or did not deliver what they had to, thereby defrauding the government¹⁸¹.

The original legislative proposal would have made contractors subject to martial law. A substitute bill provided for both civil and criminal penalties: the perpetrators were liable to pay three times the government’s damages plus a civil penalty ranging from \$5,500 to

¹⁷⁹ Sylvia, *supra* note 178 at 46, § 2:6, p.42 (quoting 1 Fred Albert Shannon, *The Origination and Administration of the United Army, 1861-65*, p.p.55-56, 58) (other sources quoted omitted)

¹⁸⁰ Federal False Claims Act, 31 U.S.C. §§ 3729-3733, as amended, May 2009

¹⁸¹ This is currently most applied in healthcare fraud

\$11,000 per false claim¹⁸². In 2015 money that would cost about \$100,000 and \$200,000 respectively¹⁸³.

The original Act enacted by the Congress provided for civil penalties of double the amount of damages sustained by the United States as a result of the false claim plus \$2,000 forfeiture for each claim submitted¹⁸⁴. The Act also authorised private individuals to sue on behalf of the United States¹⁸⁵.

The *qui tam* provision for whistle-blowers (“relators” as the Act defines them) has been included in §3730B. It states that: “A person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government”. In return for private action in the name of the government those whistle-blowers “receive at least 15 per cent but not more than 25 per cent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action”¹⁸⁶. That is if the government supports their claims, if the government does not support their claim during the proceedings the percentage ranges from minimum 25 to max 50 per cent. All reasonable procedural

¹⁸² There is a separate, but similar regulation for tax fraud, as it is specifically excluded from the False Claims Act. It is to be found in Section 7623 of the US Internal Revenue Code

¹⁸³ Sahr, R. Inflation Conversion Factors (1774-2026). Oregon University [online] Available at <http://liberalarts.oregonstate.edu/spp/polisci/research/inflation-conversion-factors> Accessed on 9 November 2016

¹⁸⁴ Legislative History, at 5273, 8

¹⁸⁵ One senator explained how the *qui tam* provision of the Act was intended to work: “The effect of the [*qui tam* provision] is simply to hold out to a confederate a strong temptation to betray his co-conspirator, and bring him to justice. The bill offers, in short, a reward to the informer who comes into court and betrays his co-conspirator, if he be such; but it is not confined that class. . . . In short, sir, I have based the [*qui tam* provision] upon the old fashioned idea of holding out a temptation and setting a rogue to catch a rogue, which is the safest and most expeditious way I have ever discovered of bringing rogues to justice”, Sylvia, *supra*, § 2:6, p.43 (quoting Cong. Globe, 37th Cong., 3d Sess. 955-56 (1863))

¹⁸⁶ §3730. (d)

expenses, fees, and costs are awarded against the defendant. So when a private person¹⁸⁷ blows the whistle by starting his or her own civil action under the False Claims Act this action may end up with a substantial bounty in a form of a percentage of the award. In the original Act, if a private citizen used the *qui tam* provision to file suit, the government had no right to intervene or control the litigation.

The Act has proved so effective for the federal government that some state and local governments have passed their own versions. According to Taxpayers Against Fraud in Washington D.C.¹⁸⁸, an organisation dedicated to promoting the False Claims Act, 21 states have their own version of the Act - California, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Louisiana, Massachusetts, Minnesota, Montana, New Jersey, New Mexico, New York, Nevada, North Carolina, Oklahoma, Rhode Island, Tennessee, Utah and Virginia - as well as the District of Columbia and the cities of New York and Chicago. In addition, Colorado, Connecticut, Louisiana, Maryland, Michigan, New Hampshire, Texas and Washington have Medicaid-only recovery statutes¹⁸⁹.

The Act survived in substantially its original form until World War II¹⁹⁰. After the Great War in the twentieth century, *qui tam* statutes had largely fallen into desuetude, although they often remained on the books. Although decisions construing the False Claims Act were relatively few before 1943, in a classic and oft-quoted passage, one court rejected the argument that

¹⁸⁷ Irrespective of them being an employee, a private investigator, etc.

¹⁸⁸ Taxpayers Against Fraud Educational Fund [online]. Available at < <http://www.taf.org/states-false-claims-acts> > [accessed on 23 September 2015]

¹⁸⁹ *Ibid.*

¹⁹⁰ Certain amendments to the Act did occur in the early 1900s (Boese (2011), *supra* note 92 at 28, p.8). The United Supreme Court declined to limit the Act's application in 1937 in *United States v. Kapp*, 302 U.S. 214 (1937). In *Kapp*, the Supreme Court rejected the defendant's argument that the government must show a monetary loss and that the representations in question were not material

courts should limit the statute's reach on the grounds that *qui tam* actions were poor public policy¹⁹¹:

“The statute is a remedial one. It is intended to protect the treasury against the hungry and unscrupulous host that encompasses it on every side, and should be construed accordingly. It was passed upon the theory, based on experience as old as modern civilization that one of the least expensive and most effective means of preventing frauds on the treasury is to make the perpetrators of them liable to actions by private persons acting ... under the strong stimulus of personal ill will or the hope of gain. Prosecutions conducted by such means compare with the ordinary methods as the enterprising privateer does to the slow-going public vessel”.

Until World War II the Act did not attract much attention¹⁹². The rise and strengthening of the executive after the Civil War brought about new ideas of the Progressive Era with their attention to social responsibility and public service. Public mood favoured philanthropy, local government and direct taxation¹⁹³.

Citizens' suit vs. *Qui Tam*

Discussion about pecuniary and altruistic motives underlying activist behavior that serves the interests of community – popular in the United States in the beginning of the XX century – juxtaposed *qui tam* and non-pecuniary forms of public service. It shows that public opinion

¹⁹¹ *United States v. Griswold*, 24 F. 361, 365-66 (D.Or.1885), *Cit.* Boese, *supra* note 92 at 28, p.10

¹⁹² Boese (2011), *supra* note 92 at 28, p.19

¹⁹³ Diner, S.J. (1998). *A Very Different Age: Americans of the Progressive Era*. Hill & Wang

and social acceptance has become an important factor warranting the survival of any given legal concept.

It is worth mentioning that in regard to *qui tam* legislation the first part of the XX century proved relative trends on both sides of the Atlantic. Both in the UK and the US the legislators as well as general public were gradually embracing the concept of spirited altruistic pro-active citizenship contrary to the low pecuniary mercenary-type motives of common informers. As a result of that trend a new class of litigants, somewhat in the middle between those two paradigmatic groups, became popular in the courtrooms – rightfully aggrieved and constitutionally friendly “private attorneys general”.

In XX century, the US Congress has chosen a different means by which to enlist the aid of private citizens in supplementing executive branch enforcement of Federal statutes: the "citizens' suit."¹⁹⁴ By this device, Congress legislatively defined legal interests (overlying those already established at common law), and authorised private citizens to protect these interests through litigation seeking monetary and/or injunctive relief against persons invading them. Most such citizens' suits supplant executive branch enforcement by compelling alleged wrongdoers' compliance with statutory directives, while other such suits compel the executive itself to enforce public law obligations against suspected wrongdoers.¹⁹⁵ Individuals bringing suits of either type got the name "private attorneys general," because Congress

¹⁹⁴ Pre-1986 Congress' authorisation of such citizens' suits was most pervasive in the field of environmental protection: Clean Air Act, 42 U.S.C. § 7604 (1982); Federal Water Pollution Control Act, 33 U.S.C. §1365 (1982). Congress has also statutorily created private causes of action in many different fields to redress injuries already recognised at common law: Clayton Antitrust Act, 15 U.S.C. §§15, 26 (1982); Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e (1982)

¹⁹⁵ Caminker, E., Comment, *The Constitutionality of Qui Tam Actions*, 99 **Yale Law Journal** 341 (1989), p.343

intended their individual actions, when aggregated, to benefit the public at large by effectuating important Federal policies.

From Congress' perspective, *qui tam* statutes and the more comfortable citizens' suit provisions have served the same purpose: both are designed to encourage private citizens to help the executive branch deter and redress violations of Federal law. However, some researches questioned the wisdom of dual public and private enforcement in general, or the context or structure of particular such schemes¹⁹⁶. But Congress' authority to determine that dual enforcement constitutes long-term social policy, and to implement that decision by enacting traditional citizens' suits provisions, was beyond serious dispute. The Supreme Court repeatedly has held that "Congress may enact statutes creating legal rights, the invasion of which creates standing" for the injured party to sue for redress¹⁹⁷. For many decades, courts have entertained suits brought by private citizens to vindicate legislatively defined interests, recognising constitutional constraints on Congress' power to authorize such suits only at the extreme margin¹⁹⁸.

In contrast to the *qui tam* enforcement the constitutional status of traditional citizens' suit scheme has remained so far unquestioned and unchallenged. The concept of private attorneys general stands comfortable to the jurists, as private citizens may represent their own interests in federal court, but not the interests of the entire polity in federal litigation. In broad terms such approach led to enactment of some amendments to the legislation

¹⁹⁶ Debate was about whether dual enforcement schemes lead to over-deterrence of benign conduct, overinvestment of social resources in the collective law enforcement effort, and/or fragmented or inconsistent policy implementation through decentralised litigation control (Caminker (1990), *supra* note 184 at 44; Pitzer (1972), *supra* note 145 at 36; Deutsch (2010), *supra* note 140 at 35

¹⁹⁷ *Linda R.S. v. Richard D.*, 410 U.S. 614, 617 n.3 (1973)

¹⁹⁸ Contemporary Article III standing doctrine suggests that some legislatively defined interests may be insufficiently "distinct and palpable" or otherwise inappropriate for judicial cognizance (Caminker, p.p.343-345)

containing *qui tam* provisions, which significantly reined in power of pecuniary motivated *qui tam* relators. The regulatory change of mind was triggered by the abuses related to the government procurement during World War II, but had been preceded by the change of public opinion since the dawn of the XX century.

1943 Retrenchment

Qui Tam retrenchment coincided with a remarkable milestone – by 1943 the number of US government employees reached a record 3,5 million. During 12 years of Franklin Roosevelt's New Deal federal government rose almost sevenfold from little more than 500 thousand in 1933¹⁹⁹. The activist government significantly expanded into economy, finance and social security, its newly formed agencies administered numerous programmes. The American public in general backed this development. Both public opinion, and administration were not in favour of private enforcement as an outdated legacy. The ideological agenda the government was pursuing focused on its agencies as solution to the challenges the society was facing, and the growing budget through the increased taxation provided governments with financing.

The spike in government's spending after beginning of the World War II spawned various *qui tam* actions over defence procurement fraud. Exemplifying popularised by Robert Merton concept of unintended consequences²⁰⁰, some relators sought to exploit what was effectively

¹⁹⁹ Schuck, P. H., (2015). *Why Government Fails So Often: And How It Can Do Better*. Princeton University Press, NJ, p. 41

²⁰⁰ Merton, Robert K. *The Unanticipated Consequences of Purposive Social Action*. 1 (6) **American Sociological Review** 894-904 [online] Available at: <<http://www.romolocapuano.com/wp-content/uploads/2014/01/MertonUnanticipated.pdf>> (accessed on 2 December 2012)

an unintended “loophole” in the Act that permitted them to file parasitic lawsuits. These relators simply copied the information contained in criminal indictments, when the relator had no information to bring to the government’s attention independently²⁰¹.

The Department of Justice sought to stop these abusive actions in 1943 in *United States ex rel. Marcus v. Hess*²⁰². The Supreme Court, however, refused to read the government’s requested limitations into the statutory language, and concluded that it was up to Congress to “correct” any problems with the Act²⁰³.

Congress responded promptly. At the request of the Attorney General, legislation was introduced that would have effectively eliminated private actions for damages and penalties by relators. A Senate Committee then sought to ensure that suits could continue to be brought by private citizens, so long as they were the “original source” of the information in question and had disclosed information in writing to the government before suit²⁰⁴.

The final version of the 1943 amendments to the False Claims Act passed after considerable debate²⁰⁵, 19 omitted the “original source” provision, and made other changes that rendered the Act less useful both to the government and to potential relators. The 1943 amendments eliminated jurisdiction over *qui tam* actions that were based on evidence or information in

²⁰¹ Legislative History, at 11, 5276317

²⁰² U.S. 537 (1943)

²⁰³ *Id.*, at 546-47

²⁰⁴ Sylvia, *supra* note 178 at 46, § 2.8, at 49 & n. 6 (citing 89 Cong. Rec. 7570 (1943))

²⁰⁵ In the congressional debate, Senator Langer of North Dakota defended the Act as necessary to adequate enforcement: “I submit that the present statute now on the books is a most desirable one. What harm can there be if 10,000 lawyers in America [are] assisting the Attorney General of the United States in digging up war frauds? In any case, the Attorney General can protect himself by filing a (civil) lawsuit at the time when he files the indictment.” 89 Cong. Rec. 7607 (Sept. 17, 1943) (quoted in *Legislative History*, at 11, 5276)

the government's possession, even if the relator had provided the information to the government²⁰⁶.

Other changes made by the 1943 amendments were to permit the Department of Justice to intervene and litigate cases filed by relators. In addition, the 1943 amendments reduced substantially the relator's share of recovery to a maximum of 10% of the proceeds in intervened cases, and a maximum of 25% of the proceeds in cases in which the government did not intervene²⁰⁷.

With all those novelties, Congress apparently "over-corrected" the Act in 1943, when it made it difficult for what might be deemed *bona fide* relators to initiate *qui tam* actions. However the resurrection of the *qui tam* 40 years later proved that the US government was not ready to abolish the concept, despite strong opposition from some lawmakers and jurists. The last 30 years brought about significant changes to the status of common informers. In a fundamental regulatory U-turn the Congress by strengthening *qui tam* provisions of the federal legislation granted American relators the second life.

The changes stemmed from the new economic policies, which put an end to the post-war dominance of the Keynesian economic thinking with its emphasis on the government intervention and expansion of the state. In 1981 the new US President Ronald Reagan had declared what later acquired a nickname "reagonomics". Its four pillars were to tighten the money supply in order to tackle inflation, rein in the growth of government spending, reduce the federal income tax and capital gains tax, and to ease government regulation²⁰⁸. As it is

²⁰⁶ Act of December 23, 1943, Ch. 377, 57 Stat. 608

²⁰⁷ Sylvia, *supra*, § 2:8, p.51

²⁰⁸ Roubini, N. and Mihm, S. (2011). *Crisis Economics: A crash course in the future of finance*. Penguin Books

shown in the next part, the resurrection of the *qui tam* enforcement was not coincidental, and its new advent was inspired primarily by what has become one of the most recognisable features of the Regan's era – huge rise in military spending.

***Qui Tam* on Offensive**

In the beginning of the 1980s the pendulum of public opinion swung in favour of a smaller government and privatisation. After domineering for most of the XX century idea of ever expanding big government and state intervention lost massive public support. Internationally the term Washington Consensus was coined to describe the strong market-based approach, and scaling back the government's activity. The number of federal employees per 100 people in the United States population has gradually decreased from over 14 per 100 in the early 1970s to a little over 10 per 100 by the late 1990s²⁰⁹. However, the government's spending was not scaled back, and the federal budget deficit was rising.

As historical analysis presented above shows, those conditions were the best for the *qui tam* to resurrect. And it did.

In 1981 the new US government significantly reduced the maximum tax rate, and lowered the top marginal tax rate from 70 to 50 per cent. In 1986 the rate was further reduced to 28 per cent²¹⁰. However, the public expenditures were significantly increased, primarily as a result

²⁰⁹ Schuck (2015), *supra* note 199 at 47

²¹⁰ "Effective Federal Tax Rates: 1979–2001". Bureau of Economic Analysis. April 2004, [online] at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/effective_tax_rates2004.pdf>, (accessed 9 April 2014)

of military spending, which was about 6 per cent of GDP for the most of Reagan's tenure. The military budget rose (in constant 2000 dollars) from \$267.1 billion in 1980 (4.9 per cent of GDP and 22.7 per cent of public expenditures) to \$393.1 billion in 1988 (5.8 per cent of GDP and 27.3 per cent of public expenditures). All these numbers had not been seen since the end of U.S. involvement in the Vietnam War in 1973²¹¹.

Following the rise of the federal deficit (from 2.65 per cent of GDP in 1980 to 3.04 per cent GDP in 1988, Reagan's final budget year), the nominal national debt rose from \$900 billion to \$2.8 trillion by year 1989²¹². The federal government has not shrunk remarkably as it had been promised, but it did not increase either – the federal bureaucracy was shown that it had its limits.

In recent history the Reagan's era got into prominence by the huge increase of military spending. Direct and indirect defence spending hit a peak of \$456.5 billion in 1987 (in projected 2005 dollars), compared with \$325.1 billion in 1980 and \$339.6 million in 1981, according to the Center for Strategic and Budgetary Assessments²¹³. Most of the increase was for procurement and research and development programs. The procurement budget leapt to \$147.3 billion from \$71.2 billion in year 1980²¹⁴.

²¹¹ Historical tables, Budget of the United States Government, [online] at <<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/hist.pdf>>, (accessed 9 April 2014)

²¹² US Federal Deficit as Percentage of GDP, [online] at <<http://www.multpl.com/u-s-federal-deficit-percent/table>>, (accessed 9 April 2014)

²¹³ *The Washington Post*, 9 June 2004

²¹⁴ *Ibid*

The government's procurement expansion in general, and rise in military spending in particular were followed – predictably -- by the soaring shenanigans of the defence contractors.

It is worth mentioning, that the 1943 amendments to FCA addressed reform of those *qui tam* procedures seen as rewarding the unworthy, and obstructing other law enforcement efforts. But by the 1980s the law lost its even theoretical grip. In year 1985 45 of the 100 largest defence contractors, including 9 of the top 10, were under investigation for multiple fraud offenses. Additionally, the Justice Department has reported that in 1985 four of the largest defence contractors have been convicted of criminal offenses, while another has been indicted and awaits trial²¹⁵. The Department of Justice has estimated fraud as draining 1 to 10 per cent of the entire Federal budget. Taking into account the spending level in 1985 of nearly \$1 trillion, fraud against the Government could be costing American taxpayers anywhere from \$10 to \$100 billion annually²¹⁶.

A new wave of the state's procurement expansion in a political environment encouraging spending discipline and administrative efficiency brought about yet another rise of *qui tam* laws, which were rediscovered by the lawmakers as a powerful weapon to combat rogue government contractors, and more broadly financial fraud in general.

The first decisive step was made by the Administration in 1986, when in the face of the evidence of extensive fraud against the United States Congress revitalised the False Claims Act through a series of amendments, thus creating the modern FCA, as it is presently

²¹⁵ S. Rept. No. 99-345, at 2-3 (1986)

²¹⁶ H. Rept. No. 99-660, at 18 (1986)

known²¹⁷. American legislators made a meaningful remark: “Several restrictive court interpretations of the Act [that] have emerged which tend to thwart the effectiveness of the statute”²¹⁸. In fact, it was not the court rulings, but mounting federal military and social spending, and prevailing at the time Small Government Theory that backed decision of the congressmen. From this point of view, the downsized government in an era of huge budget deficits and massive borrowings were happy to outsource some government functions to active citizens. Thus, while urging enactment of an anti-fraud *qui tam* measures in 1986, Senator Grassley made it clear: “Fraud allegations are climbing at a steady rate while the Justice Department’s own economic crime council last year terms the level of enforcement in defence procurement fraud inadequate”²¹⁹.

The 1986 amendments, which reinvigorated *qui tam* procedures, reflected a fairly wide array of concerns. Changes included:

- An explicit cause of action for reverse false claims (false statements calculated to reduce an obligation to pay the United States)²²⁰;
- A cause of action for retaliation against whistle-blowers²²¹;

²¹⁷ False Claims Act (FCA), 31 U.S.C. §§ 3729-3733, as amended, 2009

²¹⁸ Sylvia, *supra* note 178 at 46, p.88

²¹⁹132 Cong. Rec. 20535 (1986)

²²⁰ 31 U.S.C. 3729(a) (7)(1988 ed.) Although some believed the False Claims Act already covered such misconduct, the Justice Department urged adoption of an explicit provision to avoid any ambiguity suggested by the case law, S. Rept. No. 99-345, at 15 (1986); H. Rept. No. 99-660, at 20 (1986)

²²¹ 31 U.S.C. 3730(h) (1988 ed.). H. Rept. No. 99-660, at 23 (“Under current law, there is no federal whistle blower protection statute for persons who are fired or otherwise discriminated against by their employer because of their lawful participation in a False Claims Act case. Often, the employee within the company may be the only person who can bring the information forward. If the person stands to lose his job, he may be unwilling to expose company fraud”); S. Rept. No. 99-345, at 4-5

- An increase in sanctions from a penalty of not more than \$2,000 and double damages to a penalty of not less than \$5,000 nor more than \$10,000 and treble damages²²²;
- An increase in the maximum award available to qui tam relators from not more than 25% to not more than 30%²²³;
- An express definition of the knowledge required for a violation and declaration that a specific intent was unnecessary²²⁴;
- A specific preponderance-of-the-evidence burden of proof standard²²⁵;
- A declaration that states might act as *qui tam* relators²²⁶;
- A revised jurisdictional bar for *qui tam* suits based on matters of public knowledge²²⁷;
- An expanded statute of limitations²²⁸;
- An authorisation for government use of civil investigative demands²²⁹.

In 20 years since 1986 the beefed-up *qui tam* legislation has recovered an amount in excess of \$20 billion²³⁰. Under the *qui tam* provisions of the False Claims Act, more than \$18.5 billion

²²² Compare, 31 U.S.C. 3729 (1982 ed.), with 31 U.S.C. 3729(a) (1988 ed.). The statutory penalty had been set at \$2,000 since 1863

²²³ Compare, 31 U.S.C. 3730(c)(2)(1982 ed.), with 31 U.S.C. 3730(d)(2)(1988 ed.)

²²⁴ 31 U.S.C. 3729(b)(1988 ed.). The Committee expressed concern that absent a specific provision the courts would require actual knowledge of a statement's false character and specific intent, S. Rept. No. 99-345, at 7, citing, *United States v. Aerodex, Inc.* 469 F.2d 1003 (5th Cir. 1972); H. Rept. No. 99-660, at 20-1.

²²⁵ 31 U.S.C. 3731(c). Without a statutory provision, some courts had imposed a more demanding standard, S. Rept. No. 99-345, at 31 ("Some courts have required that the United States prove its case by clear and convincing, or even by clear, unequivocal, and convincing evidence"), citing *United States v. Ueber*, 299 F.12d 310 (6th Cir. 1962); H. Rept. No. 99-660 at 25-6

²²⁶ 55 31 U.S.C. 3732(b)(1988 ed.). At least one court had held in a Medicaid fraud action that they could not, *United States ex rel. Wisconsin v. Dean*, 729 F.2d 1100 (7th Cir. 1984)

²²⁷ 31 U.S.C. 3730(e) (1988 ed.)

²²⁸ 31 U.S.C. 3731(b) (1988 ed.)

²²⁹ 58 31 U.S.C. 3733. Civil investigative demands are a form of administrative subpoena

²³⁰ *Ibid.*

²³⁰ *The False Claims Act Correction Act (S. 2041): Strengthening the Government's Most Effective Tool Against Fraud for the 21st Century: Hearing Before the Senate Comm. on the Judiciary*, 110th Cong., 2d Sess. 1 (2008) (statement of Sen. Leahy)

has been recovered from the healthcare industry (broadly defined to include pharmaceutical and medical device companies) since 1986²³¹. In 2010 alone, more than \$3 billion was recovered under the FCA, which includes \$2.5 billion in healthcare recoveries²³². In November 2010, the Assistant Attorney General for US Department of Justice' Civil Division, Tony West, pointed out that the aggressive pursuit of fraud under the False Claims Act resulted in the government's largest two-year recovery in history, and that "[n]owhere is this more apparent than in our success in fighting health care fraud."²³³ By the time of this statement public consensus in the United States was that *qui tam* lawsuits had been unequivocal success.

2009-2010 Amendments: All-Purpose Antifraud Statute

The harsh financial crisis of 2007-2008 and the following recession had a deep profound impact on a US financial system, government finances, national debt, the way the big government operates, as well as a scope of its activities.

Between June 2007 and November 2008, Americans lost an estimated average of more than a quarter of their collective net worth. Taken together, these losses total \$8.3 trillion²³⁴. Since peaking in the second quarter of 2007, household wealth dropped down \$14 trillion by the end of 2008²³⁵.

²³¹ Press Release, Department of Justice, *Justice Department Recovers \$3 Billion in False Claims Cases in Fiscal Year 2010* (Nov. 22, 2010)

²³² *Ibid.*

²³³ *Ibid.*

²³⁴ Roger C. Altman, *The Great Crash, 2008*, Foreign Affairs. Retrieved February 27, 2009 [online] <<http://www.foreignaffairs.com/articles/63714/roger-c-altman/the-great-crash-2008>>, (accessed 3 February 2013)

²³⁵ Americans' wealth drops \$1.3 trillion, [online] at <http://money.cnn.com/2009/06/11/news/economy/Americans_wealth_drops/?postversion=2009061113>, (accessed on 25 May 2014)

Real US GDP began contracting in the third quarter of 2008 and did not return to growth until Q1 2010²³⁶. The contraction was 2.05 per cent²³⁷. Following different estimates, the fall in global trade at the time was between 25 and 35 per cent²³⁸.

The Dow Jones index fell 55 per cent – from 14,198 in October 2007 to 6,469 in March 2009²³⁹. As a result, \$50 trillion in value disappeared from world financial markets – stocks, bond, currencies – in 2008, \$11 trillion in the US²⁴⁰.

By February 2009 the US government had committed \$9.7 trillion to the bailouts, an amount sufficient to pay off more than 90 per cent of the nation's mortgages. In March that year, according to Bloomberg estimates, government loans, spending, and guarantees in the programmes soared to \$12.8 trillion, more than all the existing US national debt to date²⁴¹.

A combined total public debt outstanding rose from \$8.678 trillion as of 01 Jan 2007 to \$13.178 trillion on 1 July 2010, and further to \$17.824 on 30 September 2014, or about 103% of Q1 2014 GDP²⁴² (66 per cent GDP in 2008 pre-crisis²⁴³). The combination of the national debt and other federal obligations would bring total obligations to nearly \$62 trillion in 2Q

²³⁶ Fred Economic Data, [online] at <<http://research.stlouisfed.org/fred2/graph/?id=GDPC1>>, (accessed on 2 February 2013)

²³⁷ World Bank, [online] at <<http://data.worldbank.org/indicator/NY.GDP.MKTP.CD>>, (accessed on 3 February 2013)

²³⁸ Munchau, W. (2010). *The Meltdown Years*. McGraw Hill, NY, p. 156

²³⁹ Kaufman, H. (2009). *The Road to Financial Reformation: Warnings, Consequences, Reforms*. John Wiley and Sons, Inc., Hoboken, New Jersey

²⁴⁰ Goyette, Ch. (2009). *The Dollar Meltdown*. Portfolio of the Penguin Group (USA) Inc., New York, NY, p.56

²⁴¹ *Ibid.*, p.55

²⁴² TreasuryDirect, [online] Available at:

<<http://www.treasurydirect.gov/NP/debt/search?startMonth=01&startDay=01&startYear=2007&endMonth=09&endDay=30&endYear=2014>>, (accessed on 30 September 2014)

²⁴³ Fred Economic Data, [online] at <<http://research.stlouisfed.org/fred2/graph/?id=GFDEGDQ188S>>, (accessed on 3 February 2013)

2010²⁴⁴. Without enormous expansion of the Federal Reserve's balance sheet US Government would most likely face significant rise in its borrowing costs²⁴⁵. The chase for money has become the defining feature of the current fiscal policy, and the government's financial policy as a whole.

Following financial crisis of 2007-2008 the US regulatory system in respect of *qui tam* has incurred profound changes. These changes, however, had to deal with a growing dissent.

It could not be said that the new rise of the *qui tam* since 1986 has enjoyed a unanimous support or at least acquiescence of the society. The powerful forces mainly from the corporate sector increasingly felt discomfort with the broader ramifications of the legislation. When the *qui tam* laws started to bite after long period of just barking, a high tide of lawsuits, challenging various aspects of the new legislation, flooded the US courts. The constitutionality was one of the central and most powerful issues, raised by the plaintiffs, who targeted *qui tam*²⁴⁶. None of those challenges have been success so far, but for a brief period of time in 2004-2008 it appeared that the courts may to some degree emasculate the *qui tam* on procedural grounds following the ruling on *United States ex rel. Totten v. Bombardier Corp* (Six Circuit Court of Appeals, 2004), and *Allison Engine Co. v. United States ex rel. Sanders* (Supreme Court, 2008).

²⁴⁴ Peter G. Peterson Foundation, [online] at <<http://pgpf.org/Special-Topics/Download-the-Citizens-Guide>>, (accessed 3 February 2013)

²⁴⁵ Ricketts, L.R. and Waller, Ch.J. "The Rise and (Eventual) Fall in the Fed's Balance Sheet". *Federal Reserve Bank of St Louis*, January 2014 [online], available at: < <https://www.stlouisfed.org/publications/regional-economist/january-2014/the-rise-and-eventual-fall-in-the-feds-balance-sheet#1> > (accessed on 17 September 2015)

²⁴⁶ Doyle (2009), *supra* note 24 at 15

After the *Allison Engine*²⁴⁷ ruling, a noticeable shift occurred in lower court decisions that reflected the holding of the case. First, lower courts relied on the decision in refusing to find liability under the FCA in the absence of evidence showing a direct link between defendants' false statements to a private party and intent that the private party would submit those false claims to the government²⁴⁸. In addition, lower courts modified their pleading requirements to require that plaintiffs make additional allegations when pleading an FCA claim in order to survive dispositive motions filed by defendants.²⁴⁹ These changes made it significantly harder for plaintiffs to successfully commence claims because the additional standards required plaintiffs to plead allegations of defendants' specific intent to make a false statement or certification to the government.²⁵⁰ Defendants, on the other hand, were more protected from suits that alleged little more than technical regulatory violations²⁵¹.

Against that new backdrop, Congress swiftly made amendments, which were specifically targeted to undo the Supreme Court's decision in *Allison Engine* and the D.C. Circuit's similar decision in *Totten*²⁵². The 2009 amendments contained in FERA removed from the FCA language that the Court relied on in *Allison Engine* when ruling that a party must intend for a claim to be paid by the government in order for liability to attach.²⁵³

²⁴⁷ *Allison Engine Co. v. United States ex rel. Sanders*, 128 S.Ct. 2123 (2008)

²⁴⁸ Comeau, K.M. *False Certification Claims in Light of Allison Engine and False Claims Act Amendments Introduced in the 111th Congress*, 18 **Federal Circuit Bar Journal** 491 (2009)

²⁴⁹ *Ibid.* at 505

²⁵⁰ *Ibid.* at 506-07

²⁵¹ *Ibid.* at 506

²⁵² *United States ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488, 490 (D.C. Cir. 2004)

²⁵³ S. REP. No. 111-10, at 10-12 (2009) (citing the decisions in *Allison Engine* and *Totten* as threats to "[o]ne of the most successful tools for combating waste and abuse in Government spending") [online]

In connection with its various bailout efforts in 2009, the US Administration secured a major amendment to the FCA in the form of the elimination of the "presentment" requirement for FCA liability²⁵⁴. Previously, only claims presented to an officer or employee of the United States federal government could trigger FCA liability²⁵⁵. **The Fraud Enforcement and Recovery Act of 2009 (FERA)** amended the FCA to allow actions based on a claim submitted to "any recipient of federal funds, not just a submission to the government itself."²⁵⁶ In addition, the FERA legislation eliminated the specific intent requirement previously incorporated in the FCA²⁵⁷. The United State Supreme Court in *Allison Engine* embraced a specific intent requirement for FCA liability. Only statements made for the purpose of obtaining a payment of governmental funds were deemed actionable²⁵⁸. Under the FERA amendments to the FCA, any statement made to obtain money "to be spent or used on the Government's behalf or to advance a Government program or interest"²⁵⁹ would now be actionable.

These changes have paved the way for a wider range of statements, made in a wider range of contexts, to be the basis for a whistle-blower bounty claim.

A further step was made in March 2010 by signing into law **Patient Protection and Affordable Care Act (PPACA)**. The Act made further amendments to the False Claims Act, including:

²⁵⁴ Riley Ch. A. and Johnston, J.E. *Fraud Enforcement and Recovery Act of 2009: Expanding Fraud and False Claims Act*, 28 **Banking and Financial Services Report** 1 (2009), p.4

²⁵⁵ *Ibid.*, citing 31 U.S.C. §3729(a)(1)

²⁵⁶ *Ibid.*

²⁵⁷ *Ibid.*

²⁵⁸ 128 S.Ct. 2123, 2126 (2008)

²⁵⁹ 31 U.S.C.A. §3729, as amended by Pub. L. 11-21, 2009 S. 386

Changes to the Public Disclosure Bar. Under the previous version of the FCA, cases filed by private individuals or “relators” could be barred if it was determined that such cases were based on a public disclosure of information arising from certain proceedings, such as civil, criminal or administrative hearings, or news media reports. As a result, defendants frequently used the public disclosure bar as a defence to a plaintiff’s claims and grounds for dismissal of the same. PPACA amended the language of the FCA to allow the federal government to have the final word on whether a court may dismiss a case based on a public disclosure. The language now provides that “the court shall dismiss an action unless opposed by the Government, if substantially the same allegations or transaction alleges in the action or claim were publicly disclosed.”²⁶⁰

Original Source Requirement. A plaintiff may overcome the public disclosure bar outlined above if they qualify as an “original source,” the definition of which has also been revised by PPACA. Previously, an original source must have had “direct and independent knowledge of the information on which the allegations are based.” Under PPACA, an original source is now someone who has “knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions.”²⁶¹

Overpayments. FERA redefined “obligation” under the FCA to include “retention of any overpayments.” Accordingly, such language imposed FCA liability on any provider who received Medicare/Medicaid overpayments (accidentally or otherwise) and fails to return the money to the government. However, FERA also raised questions as to what exactly is involved in the “retention of overpayments” – for example, how long a provider had to return monies

²⁶⁰ 31 U.S.C. 3730(e)(4)(A)

²⁶¹ 31 U.S.C. 3730(e)(4)(B)

after discovering an overpayment. PPACA clarified the changes to the FCA made by FERA. Under PPACA, overpayments under Medicare and Medicaid must be reported and returned within 60 days of discovery, or the date a corresponding hospital report is due. Failure to timely report and return an overpayment exposes a provider to liability under the FCA²⁶².

Statutory Anti-Kickback Liability²⁶³. The federal AKS is a criminal statute, which makes it improper for anyone to solicit, receive, offer or pay remuneration (monetary or otherwise) in exchange for referring patients to receive certain services that are paid for by the government. Previously, many courts had interpreted the FCA to mean that claims submitted as a result of AKS violations were false claims and therefore gave rise to FCA liability (in addition to AKS penalties). However, although this was the “majority rule” among courts, there were always opportunities for courts to hold otherwise. Importantly, PPACA changed the language of the AKS to provide that claims submitted in violation of the AKS automatically constitute false claims for purposes of the FCA. Further, the new language of the AKS provides that “a person need not have actual knowledge ... or specific intent to commit a violation” of the AKS. Accordingly, providers will not be able to successfully argue that they did not know they were violating the FCA because they were not aware the AKS existed.

The biggest changes to the body of *qui tam* legislation were brought about by the **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010** (its official name tells volumes about political environment, in which it was borne to life: “An Act to Promote the Financial Stability of the United States by Improving Accountability and Transparency in the Financial

²⁶² 31 U.S.C. 3730(e)(4)(C)

²⁶³ US Anti-Kickback Statute, 42 U.S.C. 1320a-7b(b) (AKS)

System, to End ‘Too Big to Fail’, to Protect the American Taxpayer by Ending Bailouts, to Protect Consumers from Abusive Financial Services Practices, and for Other Purposes”²⁶⁴).

The Dodd-frank Act expanded whistle-blower protection and monetary incentives for *qui tam* relators even further than FERA and PPACA²⁶⁵. It also expanded scope of *qui tam* actions to the financial fraud regardless whether the government funds were engaged or not.

Novelties in regard to whistle-blower protection and encouragement spread across Titles VII, IX and X of the Dodd-Frank Act in total of 8668 words comprising slightly more than 2.2 per cent of the total wording of this statute.

Section 748 and Section 922 of the Act amended The Commodity Exchange Act of 1936, 7 U.S.C. 1 et seq. and the Securities Exchange Act of 1934, 15 U.S.C. § 78a, et seq., by adding respectively Section 23 (“Commodity Whistle-blower Incentives and Protection”) and Section 21F (“Securities Whistle-blower Incentives and Protection”). As explained in the House Conference Report, the addition of the whistle-blower provision was designed to “enhance ... incentives and protections for whistle-blowers providing information leading to successful ... enforcement actions”²⁶⁶.

The information reported under the Act to the SEC or CFTC may involve violations such as insider trading, money laundering, accounting fraud, broker-dealer violations and violations of the Foreign Corrupt Practices Act of 1977. The Commissions are authorised to share the

²⁶⁴ The Dodd-Frank Act, supra note 7 at 7 [online]

²⁶⁵ S. REP. No. 111-176, at 139-40 (2010) [online]

²⁶⁶ H.R. Conf. Rep. 111-517 [online]

information provided by the whistle-blowers with other US government agencies, as well as foreign securities authorities and foreign law enforcement.

The key of the statute's provisions are summarised below.

Whistle-blower Award. Sections 23 and 21F of the amended Acts specify that CFTC and SEC "shall pay" a financial award or awards to one or more whistle-blowers for voluntarily providing original information to the Commissions. The original information provided must lead to the Commissions recovering monetary sanctions exceeding \$1 million. Monetary sanctions include "any monies, including penalties, disgorgement, [restitution²⁶⁷] and interest ordered to be paid"²⁶⁸ by the Commissions. Original information is defined to mean information that "(A) is derived from the independent knowledge or analysis of a whistle-blower; (B) is not known to the Commission from any other source [...]; and (C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistle-blower is a source of the information"²⁶⁹. Section 924 specifically authorises a whistle-blower to receive an award "regardless of whether a violation of a provision of the securities laws, or a rule or regulation thereunder..." underlying the SEC enforcement action "occurred prior to the date of enactment" of the provision²⁷⁰.

Exclusions. Certain whistle-blowers are not entitled to receive the financial award. Those excluded include whistle-blowers who (a) are officers or employees of certain government or self-regulatory organisations or were officers or employees at the time the information was

²⁶⁷ Sec. 748 only (H.R. 4173-365)

²⁶⁸ H.R. 4173-467 [online]

²⁶⁹ H.R. 4173-365, 467 [online]

²⁷⁰ H.R. 4173-475 [online]

learned; (b) are convicted of a criminal violation related to the action for which they supplied the information; (c) gain the information through performance of an audit required under the securities laws; or (d) fail to submit the information to the CFTC or SEC in the form the Commissions require.

Amount of Award. The amount of the financial award to which qualifying whistle-blowers are entitled ranges from a guaranteed minimum of 10 per cent to a maximum of 30 per cent of the amount of the monetary sanctions that the CFTC or SEC collect in the action. The percentage awarded within this range is within the discretion of the Commissions, subject to four specified criteria: “(I) the significance of the information provided by the whistle-blower to the success of the covered judicial or administrative action; (II) the degree of assistance provided by the whistle-blower and any legal representative of the whistle-blower in a covered judicial or administrative action; (III) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistle-blowers who provide information that lead to the successful enforcement of such laws; and (IV) such additional relevant factors as the Commission may establish by rule or regulation”²⁷¹. Notably, a whistle-blower who is denied the financial award may appeal the Commissions’ decision directly to the court of appeals of the United States. A whistle-blower may not, however, appeal the amount of an award if it is within the specified range of 10 – 30 per cent of the amount collected.

Establishment of Funds. The financial award is to be paid by the CFTC and SEC out of two new funds called the “Commodity Futures Trading Commission Customer Protection Fund” and “Securities and Exchange Commission Investor Protection Fund” respectively. Certain

²⁷¹ H.R. 4173-366, 468 [online]

amounts of monetary sanctions collected by the Commissions are to be deposited into the Fund; but if the Fund do not have enough money to pay the required whistle-blower award, then the award, effectively, is to be paid out of the monetary sanction that the CFTC and SEC collect as a result of the information the whistle-blower provided.

Whistle-blower Protection. The Act creates whistle-blower protection by prohibiting retaliation against an individual who provides information to the CFTC or SEC relating to the securities law violation, or who makes required disclosures under the Commodity Exchange Act, Securities Exchange Act, the Sarbanes-Oxley Act of 2002²⁷² (SOX), or any other regulation within the Commissions' jurisdiction, or who participates in an investigation or action of the CFTC and SEC related to such original information. Section 748 and Section 922 include certain protections for whistle-blowers, including provisions that (a) protect the confidentiality of whistle-blowers; (b) expressly prohibit retaliation by employers; and (c) provide a private cause of action against a whistle-blower's employer in the event the whistle-blower is discriminated against or discharged. The Act permits civil causes of action for wrongful termination, suspension, harassment or other discrimination because the whistle-blower engaged in the protected activity of reporting information to the Commissions. If retaliation is established, the whistle-blower may recover two times the amount of back pay owed with interest, reinstatement of seniority and recovery of litigation costs, including attorneys' fees and expert witness fees. Pre-dispute contractual provisions requiring employees to arbitrate claims under the Act are now unenforceable.

²⁷² Public Company Accounting Reform and Investor Protection Act, Public Law 107-204, 116 Stat. 745, enacted 30 July 2002

The Act also amends Sarbanes-Oxley whistle-blower protections to include both publicly traded companies and their subsidiaries and affiliates whose financial information is included in the consolidated financial statements of the publicly traded company. The Act permits individuals to bring claims directly in federal court up to ten years after the alleged retaliatory conduct (and without Department of Labour involvement as required under SOX). The Act also permits a jury trial.

Section 1057 of the Act creates broad protections to employees in the financial services industry who are retaliated against for disclosing information concerning fraudulent or unlawful conduct relating to a consumer financial product or service. The financial service industry within the meaning of this section of the Act includes organisations that extend credit, service or broker loans, organisations that provide financial advisor services and organisations that provide credit counselling or consumer reporting information. Claims under this part of the Act must be filed initially with Occupational Safety and Health Administration of the Department of Labour before litigation.

The Act further strengthens the anti-retaliation provisions of the Federal False Claims Act. Section 1079A of the Act now protects the investigation of potential fraud within the meaning of the False Claims Act and prohibits retaliation against the “employee, contractor, or agent or associated others”²⁷³.

Rulemaking Authority. The CFTC and SEC are authorised by Section 748 and Section 922 to “issue such rules and regulations as may be necessary or appropriate” to implement these provisions²⁷⁴. Sections 748 and 924 of the Act require the CFTC and SEC respectively to

²⁷³ H.R. 4173-704 [online]

²⁷⁴ H.R. 4173-472, 473 [online]

establish final regulations implementing the whistle-blower programme within 270 days from the enactment of the Act.

The analysis of the whistle-blower provisions of the Financial Reform Act proves the shift from protection mode towards rewarding system in which the bounties plays the central part among all existing incentives. Having amended and enhanced the protection for whistle-blowers the new Act by and large does not bring about a revolutionary change in the system already established by the Sarbanes-Oxley and other regulatory documents, as well as by the practice of their implementation. By putting the bounty system in the centre of the whistle-blower institution American lawmakers and regulators in fact adopted a unified approach to the problem of tackling financial fraud, which brings about financial reward and *qui tam* provisions of the False Claims Act²⁷⁵ in the prosecution of corporate financial fraud. While existing system so far has appealed more to the sense of fear or to the moral principles of the potential whistle-blowers, the new approach appeals to much more practical and materialistic reasons to blow the whistle on fraud.

Remarkable in its own right these amendments signify an expressive coherence of legislative and executive branches across party lines in regard to encouraging whistleblowing.

The real-world impact of all those changes in different statutes relating to the *qui tam* made through 2009-2010 was far-reaching. The combination of new definitions serves to cover virtually any entity that receives money in any form from the federal government (and moreover, does not even receive that money), and it exposes any party who deals with such an entity to potential liability under the FCA. Inclusion of a "materiality" requirement in the

²⁷⁵ See below

new language does little to constrain the law because materiality is defined so broadly that it covers any action "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."²⁷⁶ The truly universal reach of the new statutory language is unambiguous and straightforward. By all appearances, the post-2010 FCA has become exactly what the plaintiffs in *Allison Engine* Court were afraid of: an all-purpose antifraud statute of the widest scope²⁷⁷. At present *qui tam* provisions achieved panoramic scope, unseen at least since XVI-XVII century England.

Taking this into consideration it would not be difficult to predict, that *qui tam* laws will be subject of more intensive attacks in the future, than at any given period of its millennium old history. The strong alliance of the corporate sector and dissenting legal scholars combined financial might with intellectual power, challenging *qui tam* concept in lobbying efforts, academic literature, and – most significantly – in courts. The focus of these attacks so far has been on the constitutionality of *qui tam* provisions.

As it was mentioned above, the *qui tam* legislation has survived all these challenges. However, it is too early to claim an unequivocal victory for the *qui tam* concept. The struggle will continue, but at this point it is possible to give a brief overview and sum up the discussion on the constitutionality of the *qui tam*, which at present has been upheld by the courts.

Constitutional Pass

²⁷⁶ Fraud Enforcement and Recovery Act §4

²⁷⁷ 380 F.3d 488 (D.C. Cir. 2004), *cert. denied*, 544 U.S. 1032 (2005)

The precipitous rise of *qui tam* cases in 2000s prompted coordinated response of corporate lobby groups. A number of influential American business organisations, including the Financial Services Roundtable, the Association of Corporate Counsel and the Chamber of Commerce, formally petitioned the Commodities Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) to implement rules that would significantly restrict the scope of *qui tam* relators' protections mandated by the laws implementing *qui tam* provisions. Thus, the Roundtable insisted that the CFTC and SEC required whistle-blowers to use "employer sponsored" reporting procedures, and also asked the Commissions to approve rules that would permit companies to sanction relators whose reports to law enforcement agencies caused "harm to the company."²⁷⁸

It is highly unlikely that after the harshest financial crisis and recession, which coupled with tax scandals and excesses of top corporate management to destroy or severely damage the big business' reputation, the current political and regulatory environment will let such lobbyists' efforts result in substantial legislative concessions. However, from the point of view of the American lawmakers, the importance of the constitutional issues raised by *qui tam* goes far beyond the significance of the *qui tam* action itself. These issues go to the heart of how power is allocated among the three branches of the federal government.

In fact, the much more formidable challenge of limiting the *qui tam* activity present academic dissidents, who deny constitutionality of *qui tam* lawsuits²⁷⁹. For the dissenting legal scholars,

²⁷⁸http://www.whistleblowers.org/index.php?option=com_content&task=view&id=1182&Itemid=71 (accessed on 8 November 2013)

²⁷⁹ Edgar, Jr., F., "Missing the Analytical Boat": *The Unconstitutionality of the Qui Tam Provisions of the False Claims Act*, 27 **Idaho Law Review** 319 (1990-1991); James T. Blanch, Note, *The Constitutionality of the False Claims Act's Qui Tam Provision*, 16 **Harvard Journal of Law and Public Policy** 701 (1993); Johnston, R., *1001 Attorneys General: Executive-Employee Qui Tam Suits and the Constitution*, 62 **The George Washington Law**

despite the long history of *qui tam* activity, its constitutionality is still open to question²⁸⁰. The question has revolved around *qui tam* compatibility to the clauses of two US Constitution's articles – Article II (§2 and §3) and Article III²⁸¹. Because the *qui tam* informers themselves suffer no injury, they would appear at first blush to lack the "injury in fact" required creating Article III standing²⁸². Two other requirements for a *qui tam* perceived to be necessary to prove standing -- being a) attributable to the defendant, and b) amenable to judicial relief²⁸³ -- are constant subjects of constitutional challenge²⁸⁴.

The *qui tam* statutes also raise separation of powers issues by effectively redistributing prosecution and enforcement powers from the executive branch to informers. The "good cause" requirement, and limitations on the government's ability to dismiss or settle a *qui tam* action, arguably permit the judicial branch to encroach on executive authority by giving federal courts control over, whether the government may intervene in, and terminate, a *qui*

Review 609 (1993-1994); Morgan Jr., F. and Popham, J.W., *The Last Privateers Encounter Sloppy Seas: Inconsistent Original-Source Jurisprudence Under the Federal False Claims Act*, 24 **Ohio Northern University Law Review** 163 (1998); Histed, T.L. Vermont Agency of Natural Resources v. United States ex rel. Stevens: *The Decreased Effectiveness of the Qui Tam Action*. **Law Review Michigan State University-Detroit College of Law** 161 (2001); Feola, K. *Bad Habits: The Qui Tam Provisions of the False Claims Act Are Unconstitutional under Article II*. 19 **Journal of Contemporary Health Law and Policy** 151 (2002-2003); Deutsch (2010), *supra* note 140 at 35; Lumm, D.C., Comment, *The 2009 "Clarifications" To the False Claims Act of 1863: The All-Purpose Antifraud Statute with the Fun Qui Tam Twist* 45 **Wake Forest Law Review** 527 (2010); Hans von Spakovsky and Brian Walsh, *Correcting False Claims about the New False Claims Act Legislation*, Center for Legal and Judicial Studies at The Heritage Foundation, 2 July 2009 [online] Available at: <<http://www.heritage.org/research/reports/2009/07/correcting-false-claims-about-the-new-false-claims-act-legislation>> (accessed on 8 January 2011)

²⁸⁰Because the FCA was seldom used prior to the 1986 Amendments, it was not subjected to serious constitutional challenge until that time

²⁸¹ Article II sets the Separation of Powers doctrine, the Take Care Clause, and the Appointments Clause. Article III sets the Standing Doctrine

²⁸² *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992)

²⁸³ *Vermont Agency of Nat. Resources v. United States ex rel. Stevens*, 529 U.S. 765 (2000), at 765, 774

²⁸⁴ *Friends of Earth, Inc. v. Laidlaw Environmental Services (TOC), Inc.*, 528 U.S. 167, 180-81 (2000), citing *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992): "To satisfy Article III's standing requirements, a plaintiff must show (1) it has suffered an injury in fact that is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical; (2) the injury is fairly traceable to the challenged action of the defendant; and (3) it is likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision"

tam action. The prosecutorial powers exercised by informers in pursuing *qui tam* actions raise the issue of whether informers must be appointed in conformity with the Appointments Clause of the Article II²⁸⁵.

The critics also pointed out that, in their opinion, *qui tam* statutes challenged the President's ability to fulfil his responsibilities under the take care clause²⁸⁶. Unlike the appointments clause, the take care clause does not vest authority in the President. Instead, it imposes a responsibility upon him²⁸⁷. The American Constitution was designed to allocate powers among the branches so as to prevent Congress or the courts from undermining or unduly interfering with the President's ability to perform his constitutional duties, including the duty to take care to see that the laws are faithfully executed²⁸⁸.

So far federal *qui tam* statutes have survived all types of constitutional challenges—those based on defendants' rights to have standing and those based on the doctrine of separation of powers.

The courts have found the rights required in criminal cases inapplicable, because *qui tam* actions are civil matters²⁸⁹. They have generally rejected standing arguments, because

²⁸⁵ Caminker (1989), *supra* note 184 at 44; Hamer, S. *Lincoln's Law: Constitutional and Policy Issues Posed by the Qui Tam Provisions of the False Claims Act*. 6 **Kansas Journal of Law and Public Policy** 90 (1996-1997); Bales, R.A., *A Constitutional Defense of Qui Tam*, **Wisconsin Law Review** 381 (2001)

²⁸⁶ Johnston (1994), *supra* note 265 at 67; Feola (2003), *supra* note 265 at 67

²⁸⁷ U.S. Constitution, Article II

²⁸⁸ *Morrison v. Olson*, 487 U.S. 654, 695-96 (1988); cf., *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833, 856-57 (1986)

²⁸⁹ *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 548, 549 (1943); *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 252 (1980); *Young v. United States ex rel. Vuitton et Fils S.A.*, 481 U.S. 787, 790-91 (1987); *United States v. Halper*, 490 U.S. 435, 448-49 (1989); *Hudson v. United States*, 522 U.S. 93, 101 (1997)

relators stand in the shoes of the United States, in whose name *qui tam* actions are brought²⁹⁰.

The courts have rejected appointments clause arguments, because relators hold no appointed office²⁹¹.

They have rejected take care clause arguments, because the residue of governmental control over *qui tam* actions has been considered constitutionally sufficient²⁹².

The analysis of the courts' rulings suggests that there is a firm doctrinal justification for upholding the constitutionality of the FCA *qui tam* provisions. The doctrinal justification distinguishes cases like *Morrison and Buckley*, and demonstrates that *qui tam* actions pose less of a threat to the constitutional structure than did the congressional actions struck down or upheld in those cases. Having said this, it is worth pointing out that there are two particular features of *qui tam* actions that justify treating them differently than the other constitutional cases²⁹³.

First, for the reason *qui tam* disperses power among the citizens rather than concentrating it in the hands of a single political branch, the principles underlying the separation of powers doctrine are not threatened as they are when, for example, Congress seeks to retain the power constitutionally delegated to another branch.

²⁹⁰ *United States ex rel. Stillwell v. Hughes Helicopters, Inc.*, 714 F. Supp. (C.D. Cal. 1989); *Vermont Agency* (2000), *supra* note 269 at 68

²⁹¹ *Buckley v. Valeo*, 424 U.S. 1 (1976)

²⁹² *Morrison v. Olson*, 487 U.S. 654, 695-96 (1988); *Commodity Futures Trading Commission v. Schor*, 478 U.S. 833, 856-57 (1986)

²⁹³ *Caminker*, *supra* note 184 at 44

Second, *qui tam* actions are different because they have a very specific and extensive history. *Qui tam* is over fifteen hundred years old. It existed in the American colonies prior to the independence, and was part of several statutes enacted by the First Congress. *Qui tam* provisions have been an integral part of the FCA for over hundred and fifty years.

Nearly all of the Article II cases involved efforts by Congress either to aggrandise power for itself or to vest power inappropriately in another branch of government. For example, in *Morrison*, Congress gave the judicial branch significant authority related to the independent counsel.²⁹⁴ In *Buckley*, Congress retained for itself the power to appoint members of the FEC²⁹⁵. Even in *Freytag*, in which the Court cautioned against the dispersal of the appointment power, the constitutional issue was which branch would wield the power to appoint trial judges for tax cases.²⁹⁶

Instead of vesting primary or concurrent responsibility for the enforcement of a statute in one of the three branches of government,²⁹⁷ *qui tam* provisions disperse that responsibility among the citizens. Some commentators have argued that this is a bad idea because it decreases political accountability for actions taken in the name of the government:²⁹⁸ the president must stand for election, whereas *qui tam* informers do not.

²⁹⁴ *Ibid.*

²⁹⁵ *Ibid.*

²⁹⁶ *Ibid.*

²⁹⁷ As discussed above, the FCA does give some power that ordinarily would be exercised by the executive branch to the judicial branch. Nonetheless, the primary transfer of power is from the executive branch to *qui tam* informers

²⁹⁸ Lovitt, A., Note, *Fight for Your Right to Litigate: Qui Tam, Article II, and the President*, 49 **Stanford Law Review** 853 (1997), pp. 874-75

This argument overlooks the fact that political accountability is neither the only nor the most important value served by the separation of powers doctrine. The primary purpose of the separation of powers doctrine was to preserve liberty²⁹⁹ by dispersing federal power among the three branches. James Madison wrote that "[t]he accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny."³⁰⁰ Similarly, Justice Brandeis, dissenting in *Myers v. United States*,³⁰¹ wrote: "The doctrine of the separation of powers was adopted by the Convention of 1787, not to promote efficiency but to preclude the exercise of arbitrary power. The purpose was, not to avoid friction, but, by means of the inevitable friction incident to the distribution of the governmental powers among three departments, to save the people from autocracy."³⁰²

While this purpose may be subverted by the aggrandisement of or misallocation of power to one of the governmental branches, it is not seriously threatened by a dispersal of power among the citizens. In a *qui tam* action, the true party in interest is the citizenry - who, as it is repeatedly stated in all US history textbooks – are after all, a "government of the people, by the people, [and] for the people."³⁰³ The executive officials who would be exclusively responsible for prosecuting FCA actions absent the *qui tam* provisions are merely the representatives of the people. The FCA empowers citizens to enforce the FCA directly, rather

²⁹⁹ Caminker, *supra* note 184 at 44, p. 421,

³⁰⁰ The Federalist, No. 47 (James Madison) [online] Available at: < https://www.gutenberg.org/files/1404/1404-h/1404-h.htm#link2H_4_0047 > (accessed on 20 June 2013)

³⁰¹ 272 U.S. 52 (1926) [online] Available at < <https://supreme.justia.com/cases/federal/us/272/52/case.html> > (accessed on 17 June 2013)

³⁰² *Ibid.* at 293 (Brandeis, J., dissenting)

³⁰³ President Abraham Lincoln, Address at the Dedication of the Cemetery at Gettysburg (Nov. 19, 1863), in Nina Baym et al. eds (2011). *The Norton Anthology of American Literature*, 8th ed., W.W.Norton and Company, p.1579

than indirectly through their executive branch representatives. This dispersal of power among the citizens is not only consistent with, but affirmatively promotes, the purpose of the separation of powers doctrine.

Myers and *Freytag*, of course, cautioned against the diminution and diffusion of the appointment power. Implicit in the *Freytag* Court's analysis was the fear that Congress would weaken the executive branch by diffusing executive powers within the executive branch. If power is too diffuse, then it is not effectively wielded. In *Myers*, the diminution of executive power was more direct. In both cases, the Court was concerned that by weakening the executive branch, Congress would upset the balance of powers among the branches.

The *qui tam* action, rather than limiting executive power, as in *Myers*, or diffusing power within the executive branch, as in *Freytag*, instead allocates power from the executive branch to the citizenry. The net effect, as in both *Myers* and *Freytag*, is to weaken somewhat the power of the executive branch. However, *Myers* and *Freytag* should be understood as standing for the proposition that Congress' ability to diffuse power should not be unlimited. If Congress were to attempt to privatise the whole federal law enforcement, for example, that could be cause for constitutional concern. Transferring power from a branch of government to the citizenry raises fewer constitutional concerns, and should receive less judicial scrutiny, than transfers of power from one branch to another.³⁰⁴ A statutory provision that dispersed power among the citizens simply did not pose the kind of threat to individual liberty that the unchecked power of an executive branch did.

³⁰⁴ Caminker (1989), *supra* note 184 at 44

The *qui tam* action, therefore, can be an analogue to citizen suit provisions,³⁰⁵ private suits, and corporate shareholder derivatives³⁰⁶, as it disperses power instead of concentrating it. While *Freytag* cautions against such a dispersal of power, dispersal to the citizenry, following this logic, should receive less constitutional scrutiny than inter-branch transfers of power. For this reason, and because the power transferred by *qui tam* is far from absolute, *qui tam* legislation should pass constitutional muster.

The fact that the courts were explicitly reluctant to find any basis to declare the *qui tam* unconstitutional³⁰⁷ does not constitute the ultimate victory of its proponents in this long judicial dispute. As one of the strongest *qui tam* critics pointed out: even the Supreme Court may not be always right³⁰⁸. The discussion will continue, mainly in academic literature, but also in the courtrooms. The latest constitutional challenge, *ACLU v. Holder* -- though unsuccessful -- brought by the American Civil Liberties Union (ACLU)³⁰⁹, shows that the serious economic interests presented by both sides of this supposedly theoretical argumentation will not let this fight to fade. However, it is telling that so far all recent attempts to bury or emasculate *qui tam* legislation in the USA have not succeeded.

³⁰⁵ There are two key differences between *qui tam* suits and citizen suits. First, the defendant in a *qui tam* suit is a private defendant, while the defendant in a citizens' suit usually is the government. Second, *qui tam* informers whose suit is successful are entitled to money paid to them, while the plaintiff in a citizens' suit is not. These distinctions make no constitutional difference.

³⁰⁶ Caminker, *supra*

³⁰⁷ Hamer, *supra* note 271 at 68, p. 101

³⁰⁸ Lumm (2010), *supra* note 265 at 67, p. 533

³⁰⁹ *ACLU v. Holder*, No. 09-2086 (4th Cir. March 28, 2011). ACLU alleged that the FCA's seal provisions violate the public's First Amendment right of access to judicial proceedings. ACLU also alleged that the seal provisions violate the First Amendment by "gagging" relators, and infringe on a court's inherent authority to decide on a case-by-case basis whether a particular complaint should be sealed or not. [online] available at: <http://www.healthcarelawyerblog.com/2011/03/appeals_court_rejects_aclus_ch.html> (accessed on 2 May 2012)

Conclusions

Historical analysis of the *qui tam* from the law and economics perspective shows consistent patterns observable through its two and a half millennia evolution.

Qui tam precedes the rise of modern state. Having been borne in antiquity *qui tam* was a common and important feature of law enforcement in Ancient Greece and Rome, medieval England and Iceland, colonial North America and later the United States. With nascent, underdeveloped and remote administrative bodies *qui tam* mechanism provided for law enforcement throughout the territory of a country, even where central administration never exercised a strong presence.

With an advent of modern states, however, *qui tam* did not become extinct and died out. Rather it was adopted as an ancillary mechanism to the state law enforcement in Common Law jurisdictions, and as such it remains active in the United States, enjoying recent revival and rise in popularity. Both in the USA and in England *qui tam* proved to have common patterns in its evolution, and the analysis rendered in this chapter, allows drawing some conclusions.

First of all, despite often abuse and scorn, *qui tam* as a law enforcement mechanism rarely provoked popular revolts. The omnipresent opinion that it was widely despised and hated in Ancient world and medieval England exaggerates and distorts historical facts.

The populace was most time acquiescent when *qui tam* was applied to maintain general law and order, observe trade regulations and protect consumers' interests. It loses public support

when used, as it happened in XVIII century England, to control social behavior and impose divisive moral standards.

With growing middle class and forming civil society *qui tam's*, popular support develops dynamics generally in line with prevailing public mood and political pendulum. It is reasonable to assume its growing political sensitivity.

For the last hundreds years *qui tam* has been showing a remarkable flexibility and adaptability to the needs of the governing bureaucracy, having proven to be a useful tool, subject to relevant regulation.

Though superficially the scope and scale of *qui tam* authority appear to depend on the pervasiveness and activism of the administrative machinery, more evidence given to the assumption that budget constrains play more important role in determining the exact place of *qui tam* in law enforcement strategy of the government. However, a further research is needed to establish whether the visible correlation implies causation.

Chapter II

Literature Review

The aim of this chapter is to render an analysis of the existing body of knowledge on the *qui tam* legislation and practice, and the legal forms that historically predated it. The main challenge for a literature review of the kind is that the existing literature on the subject does not provide a detailed and comprehensive analysis of the *qui tam* as a legal concept, neither is profound on a regulatory practice in whistleblower protection and its evolution through centuries. For many legal scholars and historians, *qui tam* -- in a broader sense, that comprises statutes and customs, which fit its main characteristics without bearing the name, -- remains a subject on the periphery of their studies.

The majority of works on legal history share the moral reprobation of the contemporary chronographers, who often viewed the plaintiffs in *qui tam* litigation as instrumental in suppression of civil liberties and entrenching of tyranny, or a ruthless extortion³¹⁰.

The most of American studies on *qui tam* – and the works of the US scholars quantitatively and qualitatively preponderate over other researches on this theme – either focus on practical aspects of implementation of the recently enacted *qui tam* provisions³¹¹, or take part

³¹⁰ Lofberg (1917), *infra* note 301 at 76; Bonner (1969), *supra* note 47 at 20; MacDowell (1978), *supra* note 48 at 20; Rhodes (1981), *infra* note 300 at 76; Andrews (1981), *supra* note 52 at 20; Harvey (1985) *infra* note 322 at 80; and (2003), *infra* note 307 at 77; Whitlark (2014), *supra* note 72 at 24

³¹¹ For the generally positive view on *qui tam* see: Boese (2011), *supra* note 92 at 28; Pierce (2008), *infra* note 485 at 110; Kitts (2010), *infra* note 486 at 110; Boese and McClain (1999), *infra* note 489 at 110; Bucy (1995), *infra* note 490 at 111; Bucy (1999), *infra* note 491 at 111; Bucy (2004), *infra* note 501 at 112; Callahan and Dworkin (1992), *infra* note 492 at 111; Fabrikant and Solomon (1999), *infra* note 493 at 111; Helmer (2000), *infra* note 494 at 111; Meador and Warren (1998), *infra* note 495 at 111; Oparil (1989), *infra* note 496 at 111; Phillips (1992), *infra* note 497 at 111; Fisch (1997), *infra* note 498 at 111; Thompson (2000), *infra* note 500 at 111; Landy (2010), *infra* note 501 at 111; Carrington (2007), *infra* note 507 at 112; Garrett (2012), *infra* note 513 at 114; Barger, *et al.* (2006), *infra* note 535 at 119; Alexander (1996), *infra* note 517 at 115; Gilles (2000), *infra* note 517

in an ongoing academic discussion on constitutionality of *qui tam*³¹². However there are a number of outstanding academic publications remarkable both as a source of data and as an analytic work.

Part I of this chapter presents a review of the sources on the historical development of the *qui tam* legislation with particular focus on its history in England and the United States. It starts with the scholarly publications analysing the institution of informants in Ancient Athens and Rome that preceded *qui tam* in medieval times. Then it consecutively reviews the works on *qui tam* in Anglo-Saxon and Medieval England, and respective legislation in England in XVII-XX centuries. The review of the literature on historical development of the *qui tam* concept concludes with the studies on its evolution in British America and the USA.

Part II reviews literature on *qui tam* in the contemporary United States, which mostly represents two ongoing discussions in American academia regarding *qui tam*: on its constitutionality, and on the role and place of private justice in the US legal system.

at 115; Petty (2006), *infra* note 517 at 115; Rapp (2010), *infra* note 517 at 115; Rapp (2012), *infra* note 518 at 116, and *infra* note 539 at 120; Rose (2008), *infra* note 517 at 115; Schooner (2010), *infra* note 476 at 108; Ventry (2008), *infra* note 517 at 115. For the critical analysis of *qui tam* see: Kovacic (1996), *infra* note 578 at 128; Kovacic (1998), *infra* note 580 at 128; Beck (2000), *supra* note 4 at 5; Thompson (2000), *infra* note 586 at 129; Ruhnka *et al.* (2000), *infra* note 587 at 129; Brodley (1995), *infra* note 588 at 130; Grundfest (1994), *infra* note 589 at 130; Stewart and Sunstein (1982), *infra* note 590 at 130; Blomquist (1988), *supra* note 435 at 106; Stephenson (2005), *infra* note 593 at 130; Matthew (2007), *infra* note 597 at 131; Harkins (2007-2008), *infra* note 602 at 132; von Spakovsky and Walsh (2009), *supra* note 265 at 67; Kolis (1993), *infra* note 619 at 135; Thompson (1988), *infra* note 619 at 135; Waldman (1991), *infra* note 619 at 135; Loucks (2011), *infra* note 619 at 135; Weinberg (2005), *infra* note 619 at 135

³¹² Lovitt (1997), *supra* note 284 at 71; Edgar (1991), *supra* note 265 at 67; Blanch (1993), *supra* note 265 at 67; Johnston (1994), *supra* note 265 at 67; Gausewitz Berner (2001), *infra* note 654 at 144; Krent and Shenkman (1988), *infra* note 658 at 144; Feola (2003), *supra* note 265 at 67; Caminker (1989), *supra* note 184 at 44; Sunstein (1988) and (1992), *infra* note 658 at 144; Bales (2001), *supra* note 271 at 68; Susolik (1990), *supra* note 674 at 147; Hartnett (1999), *infra* note 681 at 148; Averill (1999), *infra* note 684 at 148; Park (1991), *infra* note 685 at 149; Bucy (2002), *infra* note 686 at 149; Hamer (1997), *supra* note 271 at 68; Ho (1999), *infra* note 690 at 150; Morrison (2005), *infra* note 691 at 150; Nguyen (2005), *infra* note 701 at 152; Sturycz (2009), *infra* note 710 at 153; Lumm (2010), *supra* note 265 at 67; Senagore (2007), *infra* note 713 at 154; Gilles (2001), *infra* note 714 at 154; Shane (2000), *infra* note 715 at 154; Morgan and Popham (1998), *supra* note 165 at 67; Robertson (1994), *infra* note 718 at 154; Lee (1990), *infra* note 721 at 154

Part III comprises a review of the academic works on whistle-blowing protection, and the relevant legislation in the United States.

Literature on the historical development of the *qui tam* legislation

It is remarkable in its own sense, that historians of **classical Greece** generally ignore the *sukophantai*, regarding them as non-significant actor on the stage of Athenian democracy³¹³. Works on the Athenian legal system, on the contrary, give sycophants a prominent place³¹⁴, though often negative. Lofberg (1917) -- the first who provided a detailed analysis of sycophancy in a specific monograph³¹⁵ -- considered them a social “disease”³¹⁶. He also laid a foundation to a mistaken view of sycophancy as a profession, a view that later repeatedly appeared in works on Athenian legal system³¹⁷.

Osborne (1990), (2003) and (2010) was the first scholar who systemically disproved the tradition to call the Athenian sycophants a class of people who carried out prosecution motivated solely by pecuniary considerations³¹⁸. From his point of view, “sycophancy was vitally important to the nature and running of Athenian democracy”³¹⁹.

Harvey (1990) and (2003) agrees with Osborne that sycophants were a vital element in the Athenian democracy, and that “the right of *ho boulomenos*³²⁰ to take action on behalf of an

³¹³ For example, *The Oxford History of Classical World* (1986) does not have any reference to sycophants

³¹⁴ Bonner (1969), *supra* note 47 at 20; MacDowell (1978), *supra* note 48 at 20; Rhodes, P.J., (1981). *A Commentary on the Aristotelian Athenaion Politeia*, Oxford

³¹⁵ Lofberg, J.O. (1917). *Sycophancy in Athens*. Chicago

³¹⁶ *Ibid.* p.23

³¹⁷ Rhodes (1981) defined sycophants as “the men who took advantage of the laws... to make a profession of prosecuting, in order to obtain the rewards offered to successful prosecutors...” (*supra* note 300, pp. 444-445)

³¹⁸ Osborne (2003), *supra* note 62 at 22

³¹⁹ *Ibid.*, p.84

³²⁰ “Anyone who wishes” (Todd, S.C. (2003). *A Glossary of Athenian Legal Terms*, Demos, p.16)

injured person was amongst those reforms of Solon from which the common man gained most³²¹. But he strongly disagrees with him that “there was no trace of the profession of the sycophant in the orators”³²², presenting his arguments in favour of the point of view that *sukophantai* were the people who abused the rights of their fellow citizens, and who made their living (or the most conspicuous part of their living) of prosecution³²³.

Among the most recent works, which pay close attention to the role, public accusers (*sukophantai*) played in Ancient Athens the research published in 2011 by Fleck and Hanssen is remarkable for a number of reasons. They build up the study on the benefits and costs of legal expertise in the most famous ancient democracy on the basis of the earlier works by Bonner (1969) and MacDowell (1978), who gave some thought to the place the Athenian law provided for sycophants in litigation, and Osborne (2010), who convincingly argued that *sukophantai* could not be viewed as professional prosecutors, but predominantly activist citizens³²⁴. As Fleck and Hanssen unfold their arguments, the dominant view among the scholars in Greek history of the sycophants as a substitute of state police and prosecution in the more advanced societies³²⁵ becomes less convincing.

Classical Athens³²⁶ was one of history’s most famously democratic and commercially successful societies, and the Athenian legal code can be appreciated as the most advanced for its time. As MacDowell wrote, “the Athenians’ legal system, though less coherent than the

³²¹ David Harvey, *The Sycophant and Sycophancy: Vexatious Redefinition?*, p.103 (in Cartledge, P. *et al.* (2003). *Nomos: Essays in Athenian Law, Politics and Society*. Cambridge University Press, Cambridge)

³²² Harvey, *supra*, p.114

³²³ *Ibid.*, p.116

³²⁴ Osborne (2010), *supra* note 44 at 20, pp.205-228

³²⁵ Andrews (1981), *supra* note 52 at 20; Osborne (2003), *supra* note 62 at 22, and (2010), *supra*; Harding (2015), *supra* note 55 at 20

³²⁶ Most scholars date the Classical period from circa 480 to circa 323 BC

Romans' a few centuries later, was probably the most comprehensive that any people had yet devised"³²⁷. But, as Fleck and Hanssen point out, the Athenians consciously eschewed legal expertise. The Athenians adjudicated through voting by randomly chosen citizens, with injured parties required to act as their own prosecuting attorneys and accused parties presenting their own defences – forbidden by law from hiring experts to represent them³²⁸.

This was not the result of a general aversion to experts or primitive simplicity of the Athenian society. Athens was a complex society and the wealthiest in Ancient Greece, its economy was advanced, the demands on its legal system complex, and litigations were frequent and prodigious. As Bonner noticed, "litigiousness of Athenians was proverbial."³²⁹ MacDowell concludes about Athenians' attitude towards court procedures: "The lengthiness of the allocation procedure and the huge numbers of men included in each jury (in the fifth century as well as the fourth) show that they thought it worthwhile to devote an enormous amount of time" to the litigation³³⁰. And nevertheless, as Fleck and Hanssen write, the Athenians chose to disempower a de facto independent court of last resort as their society became more complex³³¹.

In their study the American researchers develop a model to analyse a basic trade-off related to expertise. As they point out: "The advantage of experts (over non-experts) is that experts can produce specialized information more efficiently. A disadvantage can arise, however, if experts take advantage of informational asymmetries and/or delegated powers to skew

³²⁷ MacDowell, *supra* note 48 at 20, p.8

³²⁸ Fleck and Hanssen, *supra* note 45 at 20, p.2

³²⁹ Bonner, *supra* note 47 at 20, p.96

³³⁰ MacDowell, *supra* note 48 at 20, p.40

³³¹ Fleck and Hanssen, *supra* note 45 at 20, p.2

decisions in a manner that benefits [them]... but not society as a whole”³³². Modern societies accept the trade-off in favour of expertise. But Athenians chose a different way – “they designed non-professional, low expertise legal institutions so as to limit opportunities to amass power and/or engage in rent-seeking and in order to elicit citizen preferences through direct participation in the litigation process”³³³. And it is exactly where the *sukophantai* come to prominence. As Fleck and Hanssen conclude: “[Their proliferation] reflects the basic nature of the expertise related trade-off: Athens could have done more to reduce the number of sycophants, but only by weakening the incentive for individuals to invest in public prosecution-related expertise (including private information about wrongdoing) that would enable them to bring forward socially beneficial cases”³³⁴.

Harding (2015) puts the Athenian *sukophantai* in the context of the struggle between oligarchs and democrats that pervaded the political life in Athens throughout Classical and early Hellenistic periods. Harding admits that sycophants were a divisive feature of the Athenian society, and depending on view, they could be defined as “either civic-minded citizens, or interfering busybodies”³³⁵. Despite the negative opinion on sycophants prevailing in the works of legal historians (Harvey (1985) describes a sycophant as “a *professional* blackmailer, informer and prosecutor”³³⁶), for Harding *sukophantai* were one of the important pillars of the Athenian democracy and true guardians of the laws (*nomoi*)³³⁷. For this reason they were despised by the oligarchy, and subjected to numerous attacks and

³³² *Ibid.*

³³³ *Ibid.*

³³⁴ Fleck and Hanssen, *supra* note 45 at 20, p.23

³³⁵ Harding, *supra* note 55 at 20, p.262

³³⁶ Harvey, F.D. *Dona Ferentes: Some Aspects of Bribery in Greek Politics*. P.78 (in Cartledge P.A. and Harvey, F.D. (1985), eds., CRUX. *Essays in Greek History Presented to G.E.M. de Ste. Croix on his 75th Birthday*. Exeter & London), *italics* added

³³⁷ Harding, *supra* note 55 at 20

extermination plans. Notwithstanding, this segment of the ancient democratic society survived through centuries due to the entrenched custom based on the fact that most of the Athenians strongly believed that every citizen could and – more importantly -- should prosecute any infringement of the laws.

One of the earliest sources on the **Roman** system of prosecution by private citizens, later known as *delatores* or *accusatores*, can be found in the literary legacy of Marcus Tullius Cicero (I century BC), the statesman of the later Republic. In his *De Officiis* Cicero advances his reasoning for the prosecutorial activism of the Roman citizens. In his view, the prime motivation of such actions should be a service to the country, and protection against wrongs. He does not comment upon the form of reward for such activism, neither does he explicitly deny material inducements³³⁸. Later Greco-Roman historians Tacitus, Plutarch, Pliny the Younger and Suetonius subjected *delatores* to a sharp criticism, mainly on moral grounds, but none of them provided an analysis of the role informants played in an imperial bureaucratic machinery of their time³³⁹.

In modern time, despite numerous works on Roman history and society, most scholars have not given *delatores* a comprehensive examination. The majority of works tend to deal with *delatores* only peripherally. However, some works are remarkable in their deep penetration inside the minds of Roman informants and environment, in which they acted. Thus, Rogers' study of criminal trials under Tiberius (1935)³⁴⁰ remains an important source of knowledge in respect of activities of *delatores*. But due to his focus on a political narrative he does not set

³³⁸ Cicero, *supra* note 77 at 25

³³⁹ Bunson, *supra* note 71 at 24

³⁴⁰ Rogers, R.S. (1935). *Criminal Trials and Criminal Legislation under Tiberius*. Middletown

the phenomenon of *delatores* in a broader cultural context. It is a thoughtful study of dissidents under Nero by Rudich (1993)³⁴¹, and also a work in Tacitus by Sinclair (1995)³⁴² that made convincing attempts to place *delatores* in the social and cultural context of their time. Robinson (1995)³⁴³ in her study of the framework within which the law operated, and the nature of criminal responsibility in the late Republic and Empire wrote that Roman criminal law relied on a system of prosecution by private citizens, known as *delatores*. Beginning no later than *Lex Pedia*, which retroactively made criminals of Caesar's assassins; it became common for Roman criminal statutes to offer a portion of the defendant's property as a reward for a successful prosecution.

The first systematic and comprehensive analysis of the phenomenon of *delatores* within larger historical, social and political context appeared in a monograph written by Rutledge (2001)³⁴⁴. "One would be pressed to find a better or more significant example of an informant under the Roman Empire than Judas Iscariot, -- writes Rutledge. -- But Judas was just a part of a much large phenomenon of the emperor Tiberius reign, when informants and accusers – *delatores* and *accusatores* – began their fierce attacks on those who were suspected of disloyalty towards the sovereign"³⁴⁵. Those informants, as he points out, were reflective of cultural and political values of Roman society, which little changed from Republic to Empire. Rutledge provides a detailed study of *delatores* with the aim to examine the function and role of the informants under the Early Principate from Tiberius to Domitian. Though Rutledge

³⁴¹ Rudich, V. (1993). *Political Dissidence under Nero*. Routledge, London and New York

³⁴² Sinclair, P. (1995). *Tacitus the Sententious Historian: A Sociology of Rhetoric in Annales 1-6*. Pennsylvania State University

³⁴³ Robinson (1995), *supra* note 63 at 22

³⁴⁴ Rutledge, *supra* note 67 at 23

³⁴⁵ *Ibid.*, p.3

admits that his work “is only tangentially a legal study”³⁴⁶, the book provides with a perfect description of the early *qui tam* legislation, when an uninjured party is enabled to sue for a pecuniary reward derived from a statutory forfeiture as a penalty for transgression of a law. Rutledge gives sufficient evidence, that imperial *accusatores* were necessary for the effective workings of the government such as law enforcement and checking corruption in the provinces. Following a recent trend of Roman scholars to grant a more favourable and less critical view to the imperial rule in Rome he argues that many trials involving informants during the early Principate represent an improvement in governance from the republican period³⁴⁷.

Whitlark (2014) provides some vivid anecdotes of successful *delatores* of the early Principate who amassed considerable wealth, gained political influence or simply managed to escape persecution for seditious activities by being informants and issuing mainly false accusations. He wrote that “the wealth or status that came from informing enabled people to circumvent the typical avenues of promotion... and cut across time-honoured loyalties”³⁴⁸. This was the reason why public opinion depicted informants as mostly “those arising from the dregs of society, including... slaves and freedmen, motivated by the desire for money, status, influence or preservation”³⁴⁹.

The work of Dominik and Hall (2010) is interesting by the analysis of the Roman court procedures and how those procedures defined the roles of informants (one who denounces the crime, one who witnesses, and one who prosecutes)³⁵⁰. Most of informants were far from

³⁴⁶ *Ibid.*, p.5

³⁴⁷ *Ibid.*, pp.268-269

³⁴⁸ Whitlark (2014), *supra* note 72 at 24, p.39

³⁴⁹ *Ibid.*

³⁵⁰ Dominik and Hall, *supra* note 64 at 23

illiterate outsiders and societal dregs. In Roman courts they have to show the art of rhetoric to defend their cases, a fact that indirectly points to the gradual professionalization of *delatores*³⁵¹.

The prime source of information about the private nature of criminal prosecution and execution of judgements in early medieval societies **in Europe** is a *Hrafnkels saga*³⁵², which describes in detail how in the absence of any state administration the members of the Icelandic society in the X century used in fact *qui tam* principles to prosecute offenders. The fact that the saga written in the XIII century³⁵³ depicts vividly the customs and laws of the early medieval Icelandic society shows that the *qui tam* was well known and regarded as a habitual practice on the more developed stages of the Nordic state.

Attenborough in *The Laws of the Earliest English Kings* (2013)³⁵⁴ provides the first evidence of the *qui tam* law in Anglo-Saxon **England**, thus pointing out that English *qui tam* statutes had historical antecedents in Anglo-Saxon law. In 695 A.D., Wihtred, King of Kent, issued a law prohibiting labour on the Sabbath, which included what could be described as the first written English *qui tam* enforcement provision: "If a freeman works during the forbidden time [between sunset on Saturday evening and sunset on Sunday evening], he shall forfeit his *healsfang*³⁵⁵, and the man who inform against him shall have half the fine, and [the profits arising from] the labour"³⁵⁶.

³⁵¹ *Ibid.*, p.151

³⁵² Icelandic Saga Database [online], at <http://sagadb.org/hrafnkels_saga_freysgoda.en>, (accessed on 20 June 2015)

³⁵³ Halldórsson, Óskar, (1989). "The origin and theme of Hrafnkels saga". In Tucker (Ed.), *supra* note 90 at 27, pp. 257–271

³⁵⁴ Attenborough (2013), *supra* note 86 at 27

³⁵⁵ *Healsfang* was a fine substitute for a punishment (Oxford English Dictionary (1989), 2d ed., p.1050)

³⁵⁶ Attenborough, *supra*, p.27

Professor Plucknett in *Edward I and Criminal Law* (1960)³⁵⁷ showed that the rise of a *qui tam* enforcement started prior to the consolidation of authority in the court of a single English sovereign³⁵⁸. Plucknett and Lipson in *The Economic History of England* (1959)³⁵⁹ argued that in England even before the Magna Carta common law *qui tam* provided an efficient way to pursue fraud without government prosecutors. In addition, private citizens valued *qui tam* more because it allowed them access to royal courts. The steep rise of *qui tam* enforcement began in earnest 250 years after the Norman Conquest³⁶⁰, and that rise manifested the expanding authority of an English monarch. Holdsworth in *A History of English Law* (1923)³⁶¹ gives a broad picture of medieval English and more younger UK legislation, showing significance of *qui tam* action in law enforcement on various stages of evolution of the English legal system.

The most comprehensive and profound research on the rise and decline of *qui tam* in England was published by J. Randy Beck in *The False Claims Act and the English Eradication of Qui Tam Legislation* (2000)³⁶². Beck's work remains the most detailed publication comprising the numerous *qui tam* statutes adopted by the English monarchs in medieval times, and later during the Enlightenment and Victorian periods. To date his research has been the outstanding source of knowledge on the history of *qui tam* legislation in England and the United Kingdom, and as such remains unrivalled.

³⁵⁷ Plucknett, T.F.T. (1960). *Edward I and Criminal Law*. Cambridge University Press

³⁵⁸ *Ibid.*, pp.31-32

³⁵⁹ Lipson, *supra* note 97 at 29

³⁶⁰ *Ibid.*, pp.293-94

³⁶¹ Holdsworth, W.S. (1923). *A History of English Law*. Books I & II. Methuen & Co Ltd, London [online] available at <<https://archive.org/details/historyofengli3rd02holduoft>>, (accessed 8 June 2014)

³⁶² Beck (2000), *supra* note 4 at 5

As professor Beck notes, *qui tam* in England (in his words, “an archaic form of litigation”³⁶³) served for centuries as the principal means of enforcing a wide range of statutes. England moved away from *qui tam* enforcement in the 1800s and abolished it altogether in 1951 by the Common Informers Act. Beck considers the recurring problems that beset English *qui tam* enforcement, the widespread contempt for informers, and the reasons for Parliament's eventual eradication of such legislation. Being part of a wider US discussion on the expediency and constitutionality of the *qui tam* in contemporary America the work presents arguments against *qui tam*. Beck gives three reasons to why the legislation was abolished in the UK in 1951³⁶⁴.

First, in England the *qui tam* doctrine was initially instituted as a legal adjunct to supplement country's insufficient legal machinery in order to bring more offenses to the cognizance of the courts. Informers might have been necessary at an earlier time in English history. It was not until 1856 that all areas of the country had a police force. The rise of law enforcement, both quantitative and qualitative, made that private enterprise function redundant³⁶⁵.

Second, from the point of view of the majority lawmakers at the time of abolishing the *qui tam* laws, the *qui tam* informer undermined the coherence and homogeneity of the British society³⁶⁶.

Third, *qui tam* legal principles provoked legal conflict with Scotland, for the reason Scots Law did not recognise common informer procedure before Union of Parliaments³⁶⁷.

³⁶³ *Ibid.*, p. 541

³⁶⁴ *Ibid.*, pp. 604-608

³⁶⁵ *Ibid.*, p.606

³⁶⁶ *Ibid.*, p.607

³⁶⁷ *Ibid.*

However, in fact, as Beck reluctantly admits, all the reasons above provided just a background for the UK members of Parliament. The decision to abolish legislation was made by the Parliament primarily to circumvent the still existing XVIII-century pro-faith legislation, which banned “amusements” and “entertainment” (including sales of alcohol) on Sundays (Sunday Observance Act)³⁶⁸.

Professor Beck’s work goes beyond historical analysis of *qui tam* evolution in the UK. As a strong opponent of *qui tam* legislation he provides analysis of the US and UK *qui tam* laws from the angle of a public interest, building up the case for its abolishing on the grounds that this kind of legislation is obsolete, and brings about a significant detrimental potential to haunt the whole society. His rationale focuses on an argument that *qui tam* statutes contain an inherent conflict of interest because they afford informers a pecuniary interest that often conflicts with public interests at stake in the litigation. He points out to the real world problems that stemmed from *qui tam* litigation in England -- extortion of secret settlements, fraudulent accusations, unrestrained pursuit of defendants (often for minor offenses). He views these problems as particular manifestations of a more fundamental flaw at the heart of a *qui tam* statute. By offering the successful informer a bounty *qui tam* legislation provides a personal financial interest in the law enforcement process that often conflicts with other public interests at stake in the litigation. This conflict of interest causes informers to initiate, conduct, and terminate enforcement actions in ways that are harmful to the broader community³⁶⁹.

Beck identifies particular ways in which informers seeking the largest possible bounty have

³⁶⁸ *Ibid.*, pp.604-605, p.608

³⁶⁹ *Ibid.*, pp.608-637

undermined the public interest in English *qui tam* cases and in cases brought under the *qui tam* legislation in the US:

- Diverting the public's share of the *qui tam* recovery³⁷⁰;
- Imposing unproductive and counterproductive social costs: pursue fraudulent and meritless claims, claims based on a mere technical noncompliance with reporting requirements that involved no harm to the public interest, file economically harmful prosecutions³⁷¹;
- Nurturing unlawful conduct³⁷².

From Beck's point of view, the fundamental flaw of *qui tam* legislation is that a *qui tam* informer acts primarily for the sake of the statutory bounty. The informer is "a single-minded automaton, programmed to seek out statutory violations and collect forfeitures"³⁷³. As Beck states, the issues relevant to an informer's pursuit of forfeitures are: first, the likelihood that the informer could convince a court that the defendant violated a statute; and, second, the ability of the defendant to pay the resulting penalty. This focus on wealth maximisation tends to exclude competing considerations. Beck argues, that a financially motivated informer will be relatively insensitive both to the goals of a regulatory regime and to the social costs imposed by enforcement because neither directly impacts the collection of bounties. This insensitivity towards regulatory goals and social costs is borne out in both the English history of *qui tam* enforcement and in modern experience under the US *qui tam* laws, professor Beck

³⁷⁰ *Ibid.*, pp.616-620

³⁷¹ *Ibid.*, pp.620-633

³⁷² *Ibid.*, pp.633-635

³⁷³ *Ibid.*, p.622

concludes³⁷⁴.

From his point of view, the inevitability of conflict between the interests of informers and the interests of the public -- in certain contexts -- has a huge detrimental effect on the society: empowering informers to represent the public promises to undermine the public good in situations where their interests diverge. The antagonism between the goals of informers and those of the public is harmful to the welfare of the community, sums up Beck³⁷⁵.

His preferred alternative is a state prosecution with the authority of a prosecutorial discretion. He argues, that a public prosecutor, contrary to the common informer, lacks a direct financial interest in the outcome of a case and is, therefore, more likely to take into consideration and to act upon a broader range of public interests than a *qui tam* informer³⁷⁶.

Prosecutorial discretion, Becks argues, is one of the most important mechanisms for achieving an optimal level of enforcement and avoiding unproductive social costs associated with an overzealous implementation of the regulatory regime³⁷⁷.

Following the earlier works of Block and Sidak³⁷⁸, Parker³⁷⁹, LaFave and Israel³⁸⁰, Abrams³⁸¹,

³⁷⁴ *Ibid.*

³⁷⁵ *Ibid.*, p.620

³⁷⁶ *Ibid.*, pp.620-626

³⁷⁷ *Ibid.*, pp. 620-625, 630-637

³⁷⁸ Block M. K. and Sidak, J. G., *The Cost of Antitrust Deterrence: Why Not Hang a Price Fixer Now and Then?* 68 **Georgetown Law Journal**, 1131 (1980)

³⁷⁹ Jeffrey S. Parker, *The Economics of Mens Rea*, 79 **Virginia Law Review**, 741, 760-61, 808-10 (1993)

³⁸⁰ LaFave, W., Israel, J., King, N. and Kerr, O., (2009). *Criminal Procedure*. West Academic Publishing

³⁸¹ Abrams, N., *Internal Policy: Guiding the Exercise of Prosecutorial Discretion*, 19 **UCLA Law Review**, 1, 2 (1971)

Breitel³⁸², and a case *Wayte v. US*³⁸³, Beck builds up his argument defending the merits of a prosecutorial discretion:

Public prosecutors are expected to exercise judgment in balancing the various public interests at stake in the enforcement process. A prosecutor may decide not to challenge conduct that falls within the terms of a statute, if she thinks the public would not be well served by an enforcement action. In deciding who to prosecute, she may consider the likelihood of a successful outcome in a particular case, the deterrent value of the prosecution, the blameworthiness of the particular defendant compared to other potential defendants, the extent to which the defendant's conduct implicates the policies underlying the statute, the effect of the prosecution on other interests of the public, and other similar matters. Prosecutorial discretion permits a case-by-case balancing of competing public interests implicated by each potential enforcement action. Additionally, it serves as a significant protection of liberty interests, operating as a buffer between the individual and the power of the state. Prosecutorial discretion also fosters public accountability in the decision-making process³⁸⁴.

Beck regards as a fundamental advantage that in many cases a prosecutor would advance the public interest by refraining from filing an enforcement action, notwithstanding statutory authorisation to do so. Recognising and acting upon the public interest requires evaluation of the policies behind a statutory prohibition and the costs imposed by the enforcement process³⁸⁵.

However, being a realist, Beck has to admit that even public prosecutors do not always act from the purest of motives. Public prosecutors sometimes act corruptly, egotistically, from partisan motives, or for purposes of career enhancement. But, he argues, a *qui tam* statute

³⁸² Breitel, Ch. D., *Controls in Criminal Law Enforcement*, 27 **The University of Chicago Law Review**, 427, 427 (1960)

³⁸³ *Wayte v. United States*, 470 U.S. 598, 607 (1985)

³⁸⁴ Beck (2000), *supra* note 4 at 8, pp.609-610

³⁸⁵ *Ibid.*, p.622

“intentionally turns prosecutorial decision-making into a mercenary endeavor by purposefully inserting personal financial concerns into a process that we normally seek to keep free from such complicating influences”³⁸⁶. Through provision of a bounty to a successful informer, a system of *qui tam* enforcement eliminates the personal and public protections afforded by prosecutorial discretion. A *qui tam* statute operates by appealing to the pecuniary interests of informers, and therefore, professor Beck concludes, to the extent the informer's personal financial interest conflicts with public interests affected by an enforcement action, the public interest will be inevitably sacrificed³⁸⁷.

Professor Beck’s arguments will be closely analysed in Chapter III.

By the XVII century *qui tam* in England had acquired such an important status as part of the legislation that it became a subject of analyses by two prominent English jurists, who were the first to describe and systematise it – Sir Edward Coke and Sir William Blackstone.

Edward Coke in his *Third Part of the Institutes of the Laws of England* (1664) devotes a chapter “Against Vexatious Relators, Informers, and Promoters upon penal Statutes”³⁸⁸, aimed at devising a reform to the legislation designed to control the practices of the activist bounty hunters, accustomed to bring lawsuits against their compatriots. Despite strong language about delinquent public informers -- *turbidum hominum genus*³⁸⁹, Lord Coke never advocated the abolishing of the *qui tam* laws. His aim was to improve the implementation of existing *qui tam* legislation, following the number of statutes and royal proclamations aimed at reining in

³⁸⁶ *Ibid.*, p.615

³⁸⁷ *Ibid.*, pp.635-636

³⁸⁸ Coke, *supra* note 5 at 9, pp.191-195

³⁸⁹ “A race of disorderly men” (Henry Fielding, Malvin R. Zirker (1988). *An Enquiry Into the Causes of the Late Increase of Robbers and Related Writings*. Clarendon Press, p.152)

activities of common informers, signed by Queen Elizabeth I and King James I, namely: *An Act to Redress Disorders in Common Informers* (1576)³⁹⁰, *An Act for the Continuance and Perfecting of Divers Statutes* (1587)³⁹¹, *An Act Concerning Informers* (1589)³⁹², *A Proclamation Declaring His Majesties Grace to His Subjects, Touching matters Complained of, as Publique Greevances* (1621)³⁹³, *An Act for the Ease of the Subject concerning the Informations upon Penall Statutes* (1623)³⁹⁴, and *A Proclamation for Prevention of Abuses of Informers, Clerkes, and Others in Their Prosecutions upon the Lawes, and Statutes of this Realme* (1635)³⁹⁵.

Coke identified four remaining “mischiefs”, which required further legislative redress:

First, the common informants converted “many penal Laws which were obsolete, and in time grown impossible or inconvenient to be performed, into Snares to vex and intangle the Subject”³⁹⁶.

³⁹⁰ William Kilty, (1811). *A Report of All Such English Statutes as Existed at the Time of the First Emigration of the People of Maryland: And which by Experience Have Been Found Applicable to Their Local and Other Circumstances; and of Such Others as Have Since Been Made in England Or Great-Britain, and Have Been Introduced, Used and Practised, by the Courts of Law Or Equity; and Also All Such Parts of the Same as May be Proper to be Introduced and Incorporated Into the Body of the Statute Law of the State.* Jehu Chandler [online]

³⁹¹ *A Collection of Statutes Connected with the General Administration of the Law: Arranged According to the Order of Subjects* (1817), Butterworth

³⁹² *The Statutes at Large: From the First Year of the Reign of King Edward the Fourth to the End of the Reign of Queen Elizabeth* (1763) [online]

³⁹³ *Stuart Royal Proclamations, Vol. 1: Royal Proclamations of King James I 1603–1625* [online], at <<http://oxfordindex.oup.com/view/10.1093/actrade/9780198223726.book.1>> (accessed on 18 July 2014)

³⁹⁴ Beresford, M.W. (1985). *Time and Place: Collected Essays.* A and C Black, pp.224-225

³⁹⁵ *The Proclamations of King Charles I 1625-1646* [online], available at: <<http://www.oxfordscholarlyeditions.com/view/10.1093/actrade/9780198224662.book.1/actrade-9780198224662-div1-204>> (accessed on 18 July 2014)

³⁹⁶ Coke, *supra* note 5 at 9, p.192

Second, “common informants, and many times the King’s Attorney drew all informations for any offence, in any place within the Realm of England against any penal Law, to some of the King’s Courts at Westminster, to the intolerable charge, beration, and trouble of the Subject”³⁹⁷.

Third, “in Informations etc., the offence supposed to be against the penal Law, and to be committed in one County, was at the pleasure of the Informer etc. alleged in any County where he would, where neither party nor witness was known, against the right institution of the Law, that the Jury (for their better notice) should come *de vicineto* of the place where the fact was committed”³⁹⁸.

Forth, “in divers cases the party Defendant in Informations of Actions upon the Statute were driven to plead specially, which was both chargeable and dangerous to him, if his plea were not both substantial and formal also”³⁹⁹.

Lord Coke suggests amendments to be enacted in the relevant laws in a form of a new Act to ensure the right balance between a proper law enforcement and prevention of abuse by “viperous vermin” among common informants⁴⁰⁰, who “endeavoured to have eaten out the sides of the Church and Common wealth”⁴⁰¹.

Sir William Blackstone’s *Commentaries on the Laws of England* (1765-1769)⁴⁰² provide an opportunity to analyse a *qui tam* from the point of view of a XVIII century English scholar who lived at the time when *qui tam* legislation in the UK was in its mature form. By the time

³⁹⁷ *Ibid.*

³⁹⁸ *Ibid.*, *Italics added*

³⁹⁹ *Ibid.*

⁴⁰⁰ *Ibid.*, pp.193-195

⁴⁰¹ *Ibid.*, p.194

⁴⁰² Blackstone, *supra* note 1 at 7, pp.161-162 [online]

Blackstone's *Commentaries* were published *qui tam* enforcement had been in common use for centuries, and for this reason the work of a prominent English jurist offers an expert view on the long term development of *qui tam*.

Blackstone addressed *qui tam* actions on the basis of the law of contracts. The perceived contradictions that *qui tam* actions enforce legislative mandates, while the contracts derive contractual obligations from mutual consensual agreement, in Blackstone's view, however, are non-existent. It was from the fundamental *social contract*, he points out, that the obligation to obey a penal statute is derived. Those who violated a penal statute were "bound by the fundamental contract of society to obey the directions of the legislature, and pay the forfeiture incurred to such persons as the law required"⁴⁰³.

Blackstone identified three categories of litigants, who might bring an action under the terms of a particularly English penal statute. In one group were those aggrieved by the defendant's statutory violation – the victims of the offence. It was a normal legal practice to give a cause of action to persons injured by the defendant – a way of enforcement still being a common practice. Blackstone also identified the King as a potential litigant under a penal statute, presuming officials could pursue a recovery on behalf of a sovereign – also a common practice in contemporary UK and US. Those who fell into the third category of litigants were royal subjects who could bring a *qui tam* case⁴⁰⁴.

As Blackstone noted, under many English penal statutes, a claim could be prosecuted by "any of the king's subjects" who would bring the action. Statutes permitted a person to sue for a penalty even if the person had not been injured by the conduct, giving rise to the forfeiture:

⁴⁰³ Blackstone, *supra* note 1 at 7, p. 161 [online]

⁴⁰⁴ *Ibid.*

“Sometimes one part is given to the King, to the poor, or to some public use, and the other part to the informer or prosecutor; and the suit is called a *qui tam* action, because it is brought by a person “*qui tam pro domino rege, &c., quam pro se ipso in hac parte sequitur* [who sues on behalf of the King as well as for himself]”⁴⁰⁵.

Two important implications following the authority of the *qui tam* informer to sue "on behalf of the King." First, the informer serves as the advocate for public interests that would otherwise be advanced by the public servants. If the informer succeeds in a *qui tam* action, a portion of the recovery goes to the treasury or to the fulfilment of some public purpose⁴⁰⁶.

Second, by pursuing a *qui tam* action the informer forecloses a subsequent action by government prosecutors alleging the same statutory violation. Except in cases of collusion, "the verdict passed upon the defendant in the *qui tam* suit is a bar to all others, and conclusive even to the King himself"⁴⁰⁷. This is how the *qui tam* informer stands in the shoes of a government attorney. The informer is a self-appointed prosecutor, empowered by law to enforce the social contract as if he/she is a government official.

Blackstone revised *qui tam* cases in the context of criminal proceedings. A criminal prosecution could be commenced by “information” – a procedure available to both the King and a *qui tam* informer⁴⁰⁸. The informer has a choice between either civil or criminal *qui tam* action⁴⁰⁹. English penal statutes offered the informer a variety of procedural means for

⁴⁰⁵ *Ibid.*, p. 162; for discussion on translation see *supra* note 1 at 7

⁴⁰⁶ *Ibid.*, at 161-162

⁴⁰⁷ *Ibid.*, at 162

⁴⁰⁸ *Ibid.*, at 308

⁴⁰⁹ Note, *The History and Development of Qui Tam*, 1972 **Washington University Law Quarterly** 081 (1972), [online]. Available at: <http://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=2715&context=law_lawreview> (accessed on 15 March 2013), pp. 88-89

collecting a statutory forfeiture, including a criminal information or an “action of debt” – a form of action typically used in civil contract cases⁴¹⁰.

Blackstone suggests a particular criteria to identify a *qui tam* statute:

- The statute defines an offense against the sovereign or proscribes conduct contrary to the interests of the public⁴¹¹;
- A penalty or forfeiture is imposed for violation of the statute⁴¹²;
- The statute permits a civil or criminal enforcement action pursued by a private party⁴¹³;
- The private informer need not be aggrieved and may initiate the action in the absence of any distinct, personal injury arising from the challenged conduct⁴¹⁴;
- A successful informer is entitled to a private benefit consisting of part or all of the penalty exacted from the defendant⁴¹⁵;
- The outcome of the private informer's enforcement action is binding on the government⁴¹⁶.

It must be a combination of all abovementioned features that would distinguish a *qui tam* action from other ways of statutory enforcement.

⁴¹⁰ Beck (2000), *supra* note 4 at 8, p.552

⁴¹¹ Blackstone, *supra* note 1 at 7, pp.161-162 [online]

⁴¹² *Ibid.*

⁴¹³ *Ibid.*, at 161-162, 305

⁴¹⁴ *Ibid.*, at 161

⁴¹⁵ *Ibid.*, at 161-162

⁴¹⁶ *Ibid.*, at 162

The divisive nature of *qui tam* is reflected by two prominent English jurists and police magistrates, who were the first to organise a group of professional detectives in London – the Fielding brothers.

It is worth mentioning that Sir John Fielding built up the first consistent fundamental critique of *qui tam* in England, given from the point of view of social morale. Notably he presided over the first professional police force in London in XVIII century⁴¹⁷. In his book, co-written with his half-brother Henry, *Extracts From Such of the Penal Laws, As Particularly Relate to the Peace and Good Order on This Metropolis: With Observations for the Better Execution of Some, and on the Defects of Others*⁴¹⁸ he pointed out that the rewards offered to informers had the perverse effect of discouraging public-spirited citizens from reporting evidence of crimes. The informers were berated for lacking public spiritedness, because they demanded a reward to perform the duty of every citizen. Moreover, the informer “is unconcerned about the public interest, and he is actuated purely by mercenary motives and his own cupidity⁴¹⁹. Fielding believed it was wrong for a free country to allow informers to seek redress for their own pecuniary advantage in respect of a public wrong in which they had no direct personal interests or concern. A wrong to the State should surely be atoned for by a penalty payable to the State alone, advocates Fielding⁴²⁰.

The development of *qui tam* legislation as part of a wider process of adopting English common law system in North American colonies is analysed most comprehensively in *The History and*

⁴¹⁷ *Bow Street Runners* (1742-1839), see Newman, Gerald (1997). "Bow Street Runners". *Britain in the Hanoverian age, 1714-1837: An encyclopedia*. Taylor & Francis, London

⁴¹⁸ Fielding and Fielding (1768), *supra* note 149 at 36

⁴¹⁹ *Ibid.*, pp.43-44

⁴²⁰ *Ibid.*

Development of Qui Tam (1972)⁴²¹. The research provides a detailed inside view onto the *qui tam* legislation in **pre-revolutionary America** and **early United States**. It is often quoted in more recent works on *qui tam* in the US⁴²².

The research assumes that *qui tam* as it existed in England could have been received in the United States in three ways. First, the common law *qui tam* action by which an aggrieved party sought to redress his injuries may have been adopted generally along with other portions of the common law. Secondly, specific English statutes, which could be enforced by a *qui tam* suit, may have been adopted by colonial or state legislatures. Thirdly, American legislatures may have used English law as a model for *qui tam* provisions in American statutes⁴²³.

The work states, that “no evidence has been found of a common law *qui tam* suit in our early history”⁴²⁴, and most likely that American colonial lawyers were not familiar with the early use of *qui tam* as a common law device to bring a suit in a royal as opposed to local court. Although theoretically a non-statutory *qui tam* may have been adopted together with the rest of the English common law, no actual cases to support the theory have been found⁴²⁵, conclude the researchers from the Washington University.

On the other hand, the research found “numerous examples of statutory *qui tam* in early American history”⁴²⁶. Many colonies expressly borrowed certain English statutes, which could

⁴²¹ The History and Development of *Qui Tam* (1972), *supra* at 100

⁴²² Beck (2000), *supra* note 4 at 8; Caminker (1989), *supra* note 184 at 44; Boese (2011), *supra* note 92 at 28; Bucy (2002), *infra* note 1009 at 230, and (2003), *infra* note 440 at 104; Sylvia, *supra* note 178 at 46

⁴²³ *Ibid.*, pp.93-94

⁴²⁴ *Ibid.*, p.94

⁴²⁵ *Ibid.*

⁴²⁶ *Ibid.*

be enforced by *qui tam* procedures, while some other statutes were adopted with minor modifications⁴²⁷. Moreover, American legislatures did use *qui tam* provisions similar to those found in English statutes, such as the use of informers to enforce penal laws⁴²⁸. However, while some statutes permitted informers or aggrieved parties to bring a *qui tam case* to court of justice, other statutes provided rewards to informers without permitting them to sue⁴²⁹.

The research shows, that statutes providing for *qui tam* suits were common in eighteenth century America, and the notion that *qui tam* was a joinder of public and private interests was generally accepted⁴³⁰. It is worth noting, that, as research found, many statutes had been interpreted as giving informers the same kind of contingent interest in the penalty as their English counterparts. Remarkably, in some instances, legislatures enacted statutes, which acknowledged the primacy of the first informer's suit, thereby adopting the English attitude towards multiple informers⁴³¹. The American courts also adopted the English test of whether or not a penalty could be recovered in a *qui tam* suit⁴³².

The research concludes that the reception of English law went beyond the mere recognition that an aggrieved party or informer could sue *qui tam*. The reception extended to an adoption of the English *qui tam* procedures, and "it seems clear that *qui tam* as it existed in early America was virtually identical to English *qui tam*"⁴³³. The colonies and newly established states adopted not only the letter, but also the spirit of this English legislation.

⁴²⁷ *Ibid.*, p.95

⁴²⁸ *Ibid.*

⁴²⁹ *Ibid.*, p.96

⁴³⁰ *Ibid.*

⁴³¹ *Ibid.*, p.97

⁴³² *Ibid.*

⁴³³ *Ibid.*, p.98

Literature on *qui tam* in the contemporary USA

The most comprehensive data on existing US *qui tam* legislation can be found in seminal book by J.T. Boese *Civil False Claims and Qui Tam Actions* (2011)⁴³⁴. In its latest edition, published in 2011, the prolific author on this subject complemented analysis of the federal laws and implementation practice by vast data on the growing number of *qui tam* laws and regulations adopted by the states' legislators.

With over 30 year practice as a *qui tam* lawyer, Boese in his bi-annually updated editions provides an analysis of all the major and most significant new *qui tam* cases, which contribute to the development of *qui tam* law in the US. One of the main advantages of the author is his ability to take on evolving with a particularly fast pace this area of law, and identify trends and analytical distinctions. This ability allowed Boese to categorise various issues in a logical fashion. He groups all civil claims act cases into the five most common types, namely: the "Mischarge" case⁴³⁵, the "Fraud-in-the-Inducement" or "False Negotiation" case⁴³⁶, the "False Certification" case⁴³⁷, the "Substandard Product or Service" case⁴³⁸, and the "Reverse False Claim" case⁴³⁹.

⁴³⁴ Boese (2011), *supra* note 92 at 28

⁴³⁵ *Ibid.* p. 122

⁴³⁶ *Ibid.* p. 127

⁴³⁷ *Ibid.* p. 136

⁴³⁸ *Ibid.* p. 144

⁴³⁹ *Ibid.* p. 152

Boese gives a detailed analysis of a procedure under *qui tam* cases. In Chapter IV he describes the parties in a *qui tam* case, and provides classification of *qui tam* plaintiffs (“relators”)⁴⁴⁰: current employees, former employees, competitors and competitors’ employees, multiple *qui tam* plaintiffs, state and local governments, special interest groups, attorneys and law firms, government employees, the “professional” *qui tam* relators. Practice and the procedure under the False Claims Act are analysed in the Chapter V⁴⁴¹.

Boese pays much attention to the processes of establishing and, remarkably, avoiding liability under the *qui tam* law, based on *res judicata* and collateral estoppel⁴⁴². Importantly Boese explains what the False Claims Act does not cover. Although false tax returns are almost certainly the most common false claim filed with the federal government, the False Claims Act expressly excludes such claims from the scope of its coverage. This FCA “tax bar” has been held to apply broadly whenever a false claim is made or a benefit is procured under the Internal Revenue Code, and is not limited to false income tax claims⁴⁴³. Recently, as Boese noticed, New York amended its state FCA to allow *qui tam* enforcement of tax law violations⁴⁴⁴.

Being a vociferous proponent of the *qui tam* actions Boese, however, does not provide with deep jurisprudential academic insight into complex nature of the legislation, but what he lacks is complemented by his unrivalled knowledge of the subject.

⁴⁴⁰ *Ibid.* pp. 858-913

⁴⁴¹ *Ibid.* pp. 1099-1202

⁴⁴² *Ibid.* Chapter II, pp. 307-349

⁴⁴³ *Ibid.* p. 435

⁴⁴⁴ *Ibid.* p. 1490-1491

Preceding adoption of the Patient Protection and Affordable Care Act in 2010 Boese published an article *The Past, Present, and Future of Materiality under the False Claims Act*⁴⁴⁵, dedicated to the question of materiality as a necessary element for liability under the *qui tam* law. The article significantly contributes to what had been already published on the subject in his book⁴⁴⁶, applying it to a significantly expanding health service. As Boese notes, materiality has always been one of the most important debates in the jurisprudence of the civil False Claims Act. The questions have traditionally revolved around:

- Whether materiality was an essential element for FCA liability.
- If so, how “materiality” would be defined.
- However defined, how courts would apply this element.

As Boese points out, “the reason this question is so critical is that materiality is the difference between innocence and guilt under this quasi-criminal statute”⁴⁴⁷. Materiality is not an issue in such *qui tam* cases as a hospital that bills Medicare for a “phantom” patient it has never treated, or a doctor who treats a Medicare patient and then codes the treatment at a higher reimbursement level. The issue of materiality is never litigated in these cases because the violation has been obvious—the defendant billed the government for services that it had not provided, and such rogue actions constitute the essence of a “false claim”⁴⁴⁸.

Materiality is a critical determination, however, for cases based on what some courts call “legally false” claims contrary to the “factually false” claims as described above. In a case

⁴⁴⁵ Boese, J.T. *The Past, Present, and Future of Materiality under the False Claims Act*. 3 **Saint Louis University Journal of Health Law & Policy**, 291-306 (2010)

⁴⁴⁶ Boese (2011), *supra* note 92 at 28, pp. 717-766

⁴⁴⁷ *Ibid.* p.292

⁴⁴⁸ *Ibid.*

based on a “legally false” claim, or in a “false certification” case, the defendant has provided the goods or services to the government or government beneficiary for the agreed upon price⁴⁴⁹. In every FCA case of this nature the court has to address the question whether these factually true claims become legally false because of the violation of ancillary legal requirements.

As Boese argues, the answer in most cases has depended on the application and definition of the requirement of materiality. If and when the ancillary violations are material to the government’s decision to pay the claim, concludes Boese, then assuming the necessary knowledge or intent requirement has been met the claim is false and the defendant is liable⁴⁵⁰.

Remarkable contribution to the publications on *qui tam* laws in the United States has been given by Stephan Kohn in his meticulously sourced book *Qui Tam and False Claim Acts: Federal, State and Municipal Qui Tam Laws* (2012)⁴⁵¹. The book is the second volume in the National Whistleblower Center's "Whistle-blower Laws" series.

Kohn outlines all existing US laws that allow private citizens who witness fraud against a government entity to file suit "blowing the whistle" on those contractors who produce the false claims to the government agencies, and to be awarded a portion of the monies

⁴⁴⁹ For example, a hospital has provided medically necessary services to a Medicare eligible beneficiary and billed the government the proper amount; a defense contractor has provided a part that meets all specifications and billed the government for the contract price; a university has spent federal grant money for the purposes set forth in the grant. But the hospital, contractor or grantee has violated some other regulation, statute, contract, or grant term in the course of delivering. (*Ibid.*)

⁴⁵⁰ *Ibid.* pp.298-305

⁴⁵¹ Kohn, S.M., (2012). *False Claims Acts: Federal, State and Municipal Qui Tam Laws*. National Whistleblower Center, Washington DC

recovered. The book contains the federal False Claims Act, the texts of false claims act legislation from 22 states, as well as various city governments, and more importantly the recently enacted federal *qui tam* provisions covering tax fraud.

The False Claims Act: Fraud Against the Government (2010)⁴⁵², by Phillips & Cohen partner Claire M. Sylvia provides a comprehensive treatment of the laws that have developed under the US False Claims Act. Cases brought under the act by individuals through *qui tam* actions involve the full range of government programmes, including defence procurement, healthcare, housing subsidies, and environmental clean-up. This treatise also discusses liability to the government for false claims; liability to private individuals for retaliation; and damages and other remedies, including civil penalties, the relator's share, and attorneys' fees and costs. Analysis is also given to procedure in *qui tam* actions, jurisdiction, pleadings, discovery, and other pretrial issues, interim remedies, settlement, and dismissal.

In academic literature the *qui tam*, particularly the *qui tam* provisions of the False Claims Act, have generated a significant volume of commentary. *Qui tam* has become part of the three ongoing discussions among mostly American (with some contribution from Australian⁴⁵³) academics and practicing lawyers: debates on private vs. public justice; so-called “supply-side” critique of *qui tam*, and debates on constitutionality of *qui tam* law in the US.

The vast body of academic research analyse the *qui tam* as one of the models of private enforcement, and puts it in the context of **a discussion on the merits of private comparing to public justice**⁴⁵⁴. The debate raises critical questions about the use of private enforcement

⁴⁵² Sylvia (2010), *supra* note 169 at 40

⁴⁵³ See De Maria, *supra* note 8 at 10, note 17 at 14

⁴⁵⁴ “Private Justice occurs when private persons initiate lawsuits to detect, prove, and deter public harms” (Bucy, P. *Private Justice*, 76 **South California Law Review** 1 2002-2003, p.4)

as a regulatory tool that extend far beyond the FCA, to areas as diverse as employment discrimination, environmental, antitrust, securities, and patent law. Champions of Private justice point to its rapid growth and impressive results, particularly when it comes to *qui tam*. Thus, David Engstrom in his seminal *Harnessing the Private Attorney General: Evidence from Qui Tam Litigation* (2012)⁴⁵⁵ considers some seven thousand cases since 1986 with judgments approaching three billion dollars annually -- easily rivalling and even eclipsing securities and antitrust litigation⁴⁵⁶ — as evidence of massive corporate fraud committed against the United States and, in turn, the need for a robust private enforcement role⁴⁵⁷.

To date, the most comprehensive analysis of private justice models and *qui tam* as its integrated part has been done in *Private Justice* (2003) by Pamela Bucy⁴⁵⁸. Before her work private enforcement regimes have been subject to little systematic analysis of private enforcer characteristics, much less convincing analysis of the role of private enforcement capacity within the regime as a whole. “Private justice actions have grown hodge-podge in American jurisprudence throughout the twentieth century, some created by legislatures, others by courts”, notes Bucy⁴⁵⁹. “Today, private justice actions exist in almost every area of life that law seeks to regulate. They vary in design, impact, success, disruption to economic

⁴⁵⁵ Engstrom, D. F. *Harnessing the Private Attorney General: Evidence from Qui Tam Litigation*. 112 **Columbia Law Review** 1244-1325 (2012) For review of this work see *infra*

⁴⁵⁶ The most up-to-date aggregated statistics on *qui tam* filings and impositions can be found at Civil Div., US Department of Justice, Fraud Statistics—Overview October 1, 1987–September 30, 2013 (Dec. 23, 2013), http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf; For securities litigation statistics, see Ellen M. Ryan and Laura E. Simmons, Cornerstone Research, *Securities Class Action Settlements: 2014 Review and Analysis*, available at <<http://securities.stanford.edu/research-reports/1996-2014/Settlements-Through-12-2014.pdf>>; Antitrust filing statistics can be found in Foer, A. A., Stutz, R. (2012). *Private Enforcement of Antitrust Law in the United States: A Handbook*. Edward Elgar Publishing

⁴⁵⁷ Engstrom, *supra*, pp.1246-1247

⁴⁵⁸ Bucy, *supra* at 145

⁴⁵⁹ Bucy, *supra* note 440 at 104

stability, and values communicated”⁴⁶⁰. Bucy has identified private justice as a phenomenon, analysed its various models, and assessed its impact as part of a future effective regulation.

The research describes the private justice models currently in use in the US legal system (“victim” model⁴⁶¹; “common good” model⁴⁶², comprising citizen suits and *qui tam*; and “hybrid” model⁴⁶³), noting that *qui tam* is the best in enticing those who have inside information about wrongdoing to come forward⁴⁶⁴. Bucy discusses the substantial systemic costs in using the private justice model, and suggests how a private justice paradigm can be optimally designed to minimise these costs while also maximising the benefits of private justice. She suggests that an optimally designed private justice model should be expanded into two areas: protection of the environment and protection of national financial markets⁴⁶⁵.

Contrary to the prevailing opinion among regulators that private justice actions play no more than just supplementary role to public enforcement, professor Bucy advances her vision of an optimal regulatory system:

There is little choice but to embrace private justice as part of any public regulatory system. The significant resources private justice brings to regulatory efforts are inside information about violations and entrepreneurial legal talent. Of these, the resource of inside information is more important. This is an invaluable commodity that the regulatory world must pay for⁴⁶⁶.

⁴⁶⁰ *Ibid.*

⁴⁶¹ *Ibid.* pp. 13-16, 55, 59

⁴⁶² *Ibid.* pp. 31-53, 56-59, 60-62

⁴⁶³ *Ibid.* pp. 17-31, 55-56, 59-60

⁴⁶⁴ *Ibid.* pp. 61-62

⁴⁶⁵ *Ibid.* pp. 76-80

⁴⁶⁶ *Ibid.* p. 8

In another work - *Information as a Commodity in the Regulatory World* (2002)⁴⁶⁷ – Bucy develops her analysis of the importance of the insider information about wrongdoing – “essential commodity”⁴⁶⁸ for the regulatory world. She argues, that given the increasingly global and interconnected world the regulators have no choice but to add a new institutional design of private justice to a public regulatory system to boost its effectiveness.

Analyses of the citizen suit private justice action and its juxtaposition with *qui tam* can be found in Blomquist (1988)⁴⁶⁹, Boyer and Meidinger (1985)⁴⁷⁰, Gitlen (1995)⁴⁷¹, Hodas (1995)⁴⁷², and Lehner (1995)⁴⁷³. They argue that citizen suits as private attorneys general contribute to safeguard the enforcement system. Austin (1986)⁴⁷⁴ focuses on the disruptive impact of citizen suits, while Greve (1990)⁴⁷⁵ and Miller (1984)⁴⁷⁶, noting industry arguments, dismiss them as unpersuasive and unwarranted. Rubenstein (2004)⁴⁷⁷ offers conceptual taxonomy of the term “private attorney general”, describing its origins and use in contemporary legal discourse.

⁴⁶⁷ Bucy, P.H. *Information As a Commodity in the Regulatory World*, 39 **Houston Law Review** 905 (2002)

⁴⁶⁸ *Ibid.* p. 906

⁴⁶⁹ Blomquist, R.F., *Rethinking the Citizen As Prosecutor Model of Environmental Enforcement Under the Clean Water Act: Some Overlooked Problems of Outcome-Independent Values*, 22 **Georgia Law Review** 337 (1988)

⁴⁷⁰ Boyer, B. and Meidinger, E., *Privatizing Regulatory Enforcement: A Preliminary Assessment of Citizen Suits Under Federal Environmental Law*, 34 **Buffalo Law Review** 833 (1985)

⁴⁷¹ Gitlen, Ph. H., *Private Attorneys General: Let's Do It Right*, 2 **Albany Law Environmental Outlook** 17 (1995)

⁴⁷² Hodas, D.R., *Enforcement of Environmental Law in a Triangular Federal System*, 54 **Maryland Law Review** 1552, 1561 (1995)

⁴⁷³ Lehner, P. H., *The Efficiency of Citizen's Suits*, 2 **Albany Law Environmental Outlook** 4 (1995)

⁴⁷⁴ Austin, J., Comment, *The Rise of Citizen Suit Enforcement in Environmental Law: Reconciling Private and Public Attorneys General*, 81 **Northwestern University Law Review** 220, 222 (1986)

⁴⁷⁵ Greve, M. S., *The Private Enforcement of Environmental Law*, 65 **Tulane Law Review** T 339, 399 (1990)

⁴⁷⁶ Miller, J. G., *Private Enforcement of Federal Pollution Control Laws, Parts 1-111*, 13 **Environmental Law Reporter** 10309 (1983); 14 **Environmental Law Reporter** 10063 (1984); 14 **Environmental Law Reporter** 10407 (1984)

⁴⁷⁷ Rubenstein, W.B., *On What a “Private Attorney General” Is—and Why It Matters*, 57 **Vanderbilt Law Review** 2129 (2004)

Particular analyses of securities fraud private justice actions, and *qui tam* contribution to the investigation are given by Alexander (1996)⁴⁷⁸, Bohn and Choi (1996)⁴⁷⁹, Coffee (1996)⁴⁸⁰, Coughlin (1998)⁴⁸¹, Cox (1997)⁴⁸², Fallone (1997)⁴⁸³, Grundfest (1994)⁴⁸⁴, Katz (1990)⁴⁸⁵, Macey and Miller (1991)⁴⁸⁶, Phillips and Miller (1996)⁴⁸⁷, and Seligman (1994)⁴⁸⁸. Seligman contends that deputising “private attorneys general” to police fraud on the government is the only way to combat “cozy relationships” between government agencies and industry⁴⁸⁹. Schooner (2010)⁴⁹⁰ assumes that regulatory failure is an important cause of the 2008 financial crisis. “Some might argue that the regulatory system failed because of its overactive role in financial markets. Others would claim that the regulatory system underestimated and under regulated risk. Either way, the regulatory system failed to protect the economy from a significant systemic meltdown”, notes professor Schooner⁴⁹¹. She focuses specifically on the issue of agency enforcement, and proposes a hybrid public/private *qui tam* model of enforcement as a potentially valuable enhancement to systemic risk reform.

⁴⁷⁸ Alexander, J. C., *Rethinking Damages in Securities Class Actions*, 48 **Stanford Law Review** 1487 (1996)

⁴⁷⁹ Bohn, J. and Choi, S. *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 **University of Pennsylvania Law Review** 903 (1996)

⁴⁸⁰ Coffee, J. C., Jr. *The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung*, 963 **PLI Publications** 515 (1996)

⁴⁸¹ Coughlin, P. J., *"The Private Securities Litigation Reform Act of 1995-30 Months Later," Securities Class Action Litigation Under the Private Securities Litigation Act*, 1070 **PLIICORP** 9 (1998)

⁴⁸² Cox, J. D., *Making Securities Fraud Class Actions Virtuous*, 39 **Arizona Law Review** 497 (1997)

⁴⁸³ Fallone, E. A., *Codifying the Private Cause of Action Under a Structuralist Approach*, **University of Illinois Law Review** 71 (1997)

⁴⁸⁴ Grundfest, J. A., *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 **Harvard Law Review** 963 (1994)

⁴⁸⁵ Katz, A., *The Effect of Frivolous Lawsuits on the Settlement of Litigation*, 10 *International Review of Law and Economics* 3 (1990)

⁴⁸⁶ Macey, J.R., and Miller, G.P. *The Plaintiff's' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 **University of Chicago Law Review** 1 (1991)

⁴⁸⁷ Phillips, R. M., and Miller, G. C., *The Private Securities Litigation Reform Act of 1995: Rebalancing Litigation Risks and Rewards for Class Action Plaintiffs, Defendants and Lawyers*, 51 **Business Law** 1009 (1996)

⁴⁸⁸ Seligman, J., *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Law: The Commission's Authority,"* 108 **Harvard Law Review** 438 (1994)

⁴⁸⁹ *Ibid.*, p. 453

⁴⁹⁰ Schooner, H.M., *Private Enforcement of Systemic Risk Regulation*, 20 **Creighton Law Review** 101-126 (2010)

⁴⁹¹ *Ibid.*, pp. 120-126

Some authors argue that private enforcement aids in closing public enforcement gaps. Farhang (2010)⁴⁹² notes, that “lawsuits provide a form of auto-pilot enforcement that will be difficult for bureaucrats or future legislative coalitions to subvert, short of passing a new law.”⁴⁹³ Stephenson (2005)⁴⁹⁴ brings an argument that “potential benefit of private enforcement suits is that they can correct for agency slack—that is, the tendency of government regulators to underenforce certain statutory requirements because of political pressure, lobbying by regulated entities, or the laziness or self-interest of the regulators themselves.”⁴⁹⁵

Remarkable contribution to the discussion on optimal balance of public and private enforcement has been given in *Securities Class Actions in the US Banking Sector: Between Investor Protection and Bank Stability* (2009)⁴⁹⁶ by Lucia Dalla Pellegrina and Margherita Saraceno, who conducted an interesting study on the indirect positive impact that securities class action suits can have on bank stability. Though not dedicated to *qui tam* this research addresses the same question of the private enforcement efficiency. The authors concluded that securities class actions may serve as "a Red Flag of bank instability" in that such actions tend to focus on banks that take on more risk and those that are less efficient, particularly

⁴⁹² Farhang, S., (2010). *The Litigation State: Public Regulation and Private Lawsuits in the United States*, Princeton University Press

⁴⁹³ *Ibid.*, p. 20

⁴⁹⁴ Stephenson, M. C., *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 *Virginia Law Review* 93-110 (2005)

⁴⁹⁵ *Ibid.*, p.110

⁴⁹⁶ Dalla Pellegrina, L. and Saraceno, M., *Securities Class Actions in the US Banking Sector: Between Investor Protection and Bank Stability* (CLEA 2009 Annual Meeting Paper, Paolo Baffi Centre Research Paper No. 2009-61, 2009) [online]. Available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1427814> or <<http://dx.doi.org/10.2139/ssrn.1427814>>, (accessed on 7 June 2013)

those with high ratio of bad to good loans and a low interest margin. They argue that the securities class action can serve as an effective complement to agency supervision of banks.

The rapid increase in the use of private contractors by the governments contributed to the discussion on the dichotomy of private and public enforcement. Private contractors have begun to perform functions that, until very recently, were thought of as inherently governmental⁴⁹⁷. As contractors perform more and more characteristically governmental functions they are required to meet obligations beyond those of parties doing business solely in the private sector. The obligations of contractors have expanded along with their duties. Some writers to consider the subject have adopted the view that the increased use of contractors is a result of an ideological downsizing of government⁴⁹⁸, and declared the perceived "contractor experiment" to be a failure. The solution offered is simple -- an increase in the size of government. However, as Pierce (2008)⁴⁹⁹ and Kitts (2010)⁵⁰⁰ note, the government's increased reliance on contractors is the result of a complex interplay of factors with no simple solution, while private enforcement, and particularly *qui tam* model, paves the way to the rise in efficiency of control over government contracts and its procurement system. As Kitts points out, "It is important that all parties who do business with and receive money from the federal government understand that the nature of the game has changed ... these *qui tam* provisions are necessary because any attempt to regulate sophisticated contractors and other recipients of government funds by written rules alone is destined to

⁴⁹⁷ Verkuil, P.R., (2007). *Outsourcing Sovereignty: Why Privatization of Government Functions Threatens Democracy and What We Can Do About It*, Cambridge University Press

⁴⁹⁸ Verkuil, *supra*; Parrillo, N., *The De-Privatization of American Warfare*, 19 **Yale Journal of Law & the Humanities** (2007)

⁴⁹⁹ Pierce, R. J., Jr., *Outsourcing is Not Our Only Problem*, 76 **George Washington Law Review** 1216 (2008) (reviewing Paul Verkuil)

⁵⁰⁰ Kitts, Z., *Public Trust and the Role of Qui Tam Relators in the Regulatory Framework*, 7 **Journal of Law, Economics & Policy** 1-23 (2010)

fail”⁵⁰¹. He goes even further to declare that those that wish to do away with the three-party regulatory system created by the *qui tam* mechanism would prefer a country “dominated by the wealthy and powerful, a world where dissenting individuals would be ground under the heel of the elite”⁵⁰².

The vast body of academic research is dedicated to the analyses of the *qui tam* provisions of the American legal system, and the critique of the FCA and Dodd-Frank Act enhancement of *qui tam* as a regulatory mechanism. Among those who take generally positive view on the *qui tam* as a regulatory tool the most cited are Boese and McClain (1999)⁵⁰³, Bucy (1995)⁵⁰⁴ and (1999)⁵⁰⁵, Callahan and Dworkin (1992)⁵⁰⁶, Fabrikant and Solomon (1999)⁵⁰⁷, Helmer (2000)⁵⁰⁸, Meador and Warren (1998)⁵⁰⁹, Oparil (1989)⁵¹⁰, and Phillips (1992)⁵¹¹. Fisch (1997)⁵¹² expresses strong support for the *qui tam* regime, and advocates export of *qui tam* mechanism to other regulatory contexts, including securities and antitrust law. Helmer (2000) hails FCA’s “spectacular results” and recommends that courts more frequently award

⁵⁰¹ *Ibid.* p. 23

⁵⁰² *Ibid.*

⁵⁰³ Boese, J. T., and McClain, B. C., *Why Thompson Is Wrong: Misuse of the False Claims Act to Enforce the Anti-Kickback Act*, 51 **Alabama Law Review** 1 (1999)

⁵⁰⁴ Bucy, P. H., *Civil Prosecution of Health Care Fraud*, 30 **Wake Forest Law Review** 693 (1995)

⁵⁰⁵ Bucy, P. H., *Growing Pains: Using the False Claims Act to Combat Health Care Fraud*, 51 **Alabama Law Review** 57 (1999)

⁵⁰⁶ Callahan, E. and Dworkin M., *Do Good and Get Rich: Financial incentives for Whistleblowing and the False Claims Act*, 37 **Villanova Law Review** 273 (1992)

⁵⁰⁷ Fabrikant, R., and Solomon, G. E., *Application of the Federal False Claims Act to Regulatory Compliance Issues in the Health Care Industry*, 51 **Alabama Law Review** 105 (1999)

⁵⁰⁸ Helmer, J. B., Jr., *How Great Is Thy Bounty: Relator's Share Calculations Pursuant to the False Claims Act*, 68 **University of Cincinnati Law Review** 737-61 (2000)

⁵⁰⁹ Meador, P., and Warren, E., S., *The False Claims Act: A Civil War Relic Evolves Into a Modern Weapon*, 65 **Tennessee Law Review** 455 (1998)

⁵¹⁰ Oparil, R. J., *The Coming Impact of the Amended False Claims Act*, 22 **Akron Law Review** 525 (1989)

⁵¹¹ Phillips, E. A., *A Proposed Michigan False Claims Act: Resurrecting Qui Tam As a Practical and Effective Weapon to Combat Fraud Against the Government*, 9 Thomas M. **Cooley Law Review** 59 (1992)

⁵¹² Fisch, J. E., *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 **Law and Contemporary Problems**, at 167, 198–202 (Autumn 1997)

“attractive relator’s shares” to incentivise more whistleblowing⁵¹³. Thompson (2000)⁵¹⁴ surveys *qui tam* enforcement landscape, and suggests “initial verdict” is it has been successful, justifying its expansion to environmental protection. Landy (2010)⁵¹⁵ claims FCA’s *qui tam* provisions have been “extraordinarily successful as a regulatory tool”, urging Congress to amend FCA to explicitly grant public employees standing to serve as relators.

Among the works published in recent years some are worth particular attention, because their authors either close to the mainstream thinking of the American legislative and regulatory establishment, or proved to be visionaries in predicting development of the law enforcement.

Pamela Bucy has been one of such visionaries. In her *Game theory and the Civil Claims Act: Iterated Games and Close-knit Groups* (2004)⁵¹⁶ professor Bucy has applied game theory principles identified by Robert Axelrod and Robert Ellickson⁵¹⁷ to the *qui tam* provisions of the False Claims Act. She highlights basic principles of game theory identifying two game theory concepts especially pertinent to FCA practice: “iterated”, or repeated, games, and game playing within “close-knit” groups⁵¹⁸. The article then analyses the optimal strategies for players of close-knit groups involved in iterated games in the context of the regulatory game created by the civil FCA. The optimal strategy that Bucy proposes is a close cooperation

⁵¹³ Helmer (2000), *supra* note 494, p. 753

⁵¹⁴ Thompson, Jr., B.H., *The Continuing Innovation of Citizen Enforcement*, **University of Illinois Law Review** 185-233 (2000)

⁵¹⁵ Landy, B. M., Note, *Deterring Fraud to Increase Public Confidence: Why Congress Should Allow Government Employees to File Qui Tam Lawsuits*, 94 **Minnesota Law Review** 1239, 1264–68 (2010)

⁵¹⁶ Bucy, P. H., *Game theory and the Civil Claims Act: Iterated Games and Close-knit Groups*, 35 **Loyola University Chicago Law Journal** 1021-1048 (2003-2004)

⁵¹⁷ Ellickson, R. C., (1991). *Order Without Law: How Neighbors Settle Disputes*. Harvard University Press; Axelrod, R., (1984). *The Evolution of Cooperation*. Basic Books, New York

⁵¹⁸ *Ibid.* pp. 1027-1028

between the Department of Justice and the *qui tam* relators⁵¹⁹. She also advocates expansion of the FCA model from primarily the government contracting to other areas, such as protection of financial and securities markets (what happened in 2010 after enactment of the Dodd-Frank Act), and protection of the environment⁵²⁰.

Carrington in *Law and Transnational Corruption: the Need for Lincoln's Law Abroad* (2007)⁵²¹ points out to the relevance of the American practice of privatised law enforcement to the corruption problem in foreign jurisdictions. In his view, this relevance results from the historical fact that it is a product of a nineteenth-century culture sharing very limited trust in government and its officers. Its cultural situation thus bears some resemblance to the situations both in impoverished lands and in the community of nations hoping for enforcement of international law prohibiting corrupt practices. It is a system of law enforcement that reduces the law's dependence on the integrity of judges, prosecutors, and other public servants. "Wherever public integrity is in great doubt, the American experience may offer useful instruction", argues Carrington⁵²².

In his view, Congress could make the False Claims Act process available to foreign governments and their citizens. Foreign nationals could be permitted to file *qui tam* proceedings in the name of their governments that have been corrupted by a defendant who is subject to the personal jurisdiction of the court in which the action is brought. Congress also could prescribe an award of damages commensurate with the damages provisions of the

⁵¹⁹ *Ibid.* pp. 1028-1045

⁵²⁰ *Ibid.* pp. 1045-1046

⁵²¹ Carrington, P., *Law and Transnational Corruption: The Need for Lincoln's Law Abroad*, 70 **Law and Contemporary Problems** 109-138 (2007)

⁵²² *Ibid.* p.112

False Claims Act in order to provide individuals and their lawyers, as well as governments, with the incentives needed to investigate apparent corrupt practices and to advance their claims. Such a foreign subject or citizen could be equipped with procedural rights equal to those conferred on American citizens by the US courts (these rights are not generally available in courts of most other nations). They include: the "American Rule" that losers do not pay winners' attorneys' fees in the absence of specific legislation to the contrary; access to contingent-fee lawyers; the right to discover evidence in the United States and abroad; trial by jury; a standard of proof requiring no more than a demonstration of probability of guilt; and the possibility of a class action when many firms or persons have suffered damage as a result of one proven bribe⁵²³.

Carrington admits that there must be at least three limitations on the effectiveness of such a solo effort by the United States to correct the international problem. One is the limit of the long arm of American courts. Jurisdictional limits would obviously be no problem for suits against defendants in the US, but would put out of reach of the deterrent effect all those foreign firms not subject to the personal jurisdiction of American courts⁵²⁴. A second limitation is the limited ability of American courts to enforce judgments against defendants whose assets are beyond the American reach⁵²⁵. A third limitation on the utility of such American law is the limited ability of the US government to protect foreign whistle-blowers from retaliation to the degree they are able to protect US relators⁵²⁶.

⁵²³ *Ibid.* p. 133

⁵²⁴ *Ibid.* p. 134

⁵²⁵ *Ibid.* pp. 134-135

⁵²⁶ *Ibid.* p. 135

Garrett in *Dodd-Frank's Whistle-blower Provision Fails to Go Far Enough: Making the Case for a Qui Tam Provision in a Revised Foreign Corrupt Practices Act* (2012)⁵²⁷ presents another expansionist view on *qui tam*, arguing for amending FCPA to include *qui tam* provisions. Pointing out that “the reach of Dodd–Frank is substantial”⁵²⁸, professor Garrett in his own words, “goes against the general business consensus and argues that Dodd–Frank does not go far enough with regard to how the whistle-blower provision is applied to the Foreign Corrupt Practices Act”⁵²⁹. Dodd–Frank imposes statutory roadblocks and administrative hindrances that will prevent the whistle-blower provision from contributing to the enforcement of the FCPA, notes Garrett. While Dodd–Frank’s whistle-blower provision rests on sound principles in that it recognises the importance of including private citizens in detecting financial crimes, argues Garrett, private citizens can contribute more than being mere informants. He builds up argument for including a *qui tam* provision that would allow people to sue FCPA violators on behalf of the government, “and for themselves”, thereby enforcing the FCPA more effectively⁵³⁰.

There is a substantial body of academic research on a broader set of implications concerning proliferating calls to export the *qui tam* and agency oversight mechanisms to other regulatory areas⁵³¹.

⁵²⁷ Garrett, B. N., *Dodd-Frank's Whistleblower Provision Fails to Go Far Enough: Making the Case for a Qui Tam Provision in a Revised Foreign Corrupt Practices Act*, 81 **University of Cincinnati Law Review** 765-794 (2012)

⁵²⁸ *Ibid.*, p.766

⁵²⁹ *Ibid.*, p.767

⁵³⁰ *Ibid.*, pp.782-792

⁵³¹ See Alexander, J.C., *Rethinking Damages in Securities Class Actions*, 48 **Stanford Law Review** 1487 (1996) (proposing expansion to securities litigation); Gilles, M.E., *Reinventing Structural Reform Litigation: Deputizing Private Citizens in the Enforcement of Civil Rights*, 100 **Columbia Law Review** 1384 (2000) (civil rights); Petty, A.R., *How Qui Tam Actions Could Fight Public Corruption*, 39 **University of Michigan Journal of Law Reform** 851 (2006) (public corruption); Rapp, G. Ch., *False Claims, Not Securities Fraud: Towards Corporate Governance by Whistleblowers*, 15 **Nexus Journal of Law and Policy** 55 (2010), University of Toledo Legal Studies Research Paper No. 2010-17 [online] Available at: <<http://ssrn.com/abstract=1672755>> (accessed on 8 October 2014) (securities); Rose, A.M., *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public*

Although bounty programmes have expanded, powerful industry lobbies have successfully resisted the introduction of *qui tam* structures outside of the FCA context, at least on the federal level, argues Rapp in *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistle-blower Provisions of the Dodd– Frank Act (2012)*⁵³². While whistle-blowers were provided with a process for seeking rewards, Dodd-Frank ACT failed to embrace the crucial *qui tam* provisions of the FCA that allow whistle-blowers to litigate cases independently from federal action. “Perhaps because of the power of the Wall Street lobby, which regularly puts the “Military-Industrial Complex” to shame, whistle-blowers under Dodd-Frank will remain spectators in most stages of the enforcement actions triggered by their revelations,” writes Rapp⁵³³.

Rapp identifies four reasons why the SEC is likely to remain a roadblock to whistle-blowers seeking bounties under the new law. First, the SEC will continue to face resource limitations in enforcing the programme⁵³⁴. Second, the dual responsibility for whistle-blowers now in effect (with the Department of Labour reviewing Sarbanes-Oxley Act retaliation claims and the Securities and Exchange Commission (SEC) reviewing claims for bounties) may result in relatively less regulatory attention from both agencies⁵³⁵. Third, the SEC has long been plagued by allegations of “regulatory capture” by industry⁵³⁶. Fourth, the SEC may continue

and Private Enforcement of Rule 10B-5, 108 **Columbia Law Review** 1301 (2008) (securities); Schooner (2010), *supra* 476 at 108 (securities and financial regulation); Ventry, Jr., D. J., *Whistleblowers and Qui Tam for Tax*, 61 **Tax Lawyer** 357, 359 (2008) (tax)

⁵³² Rapp, G. Ch., *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd– Frank Act*, **Brigham Young University Law Review** 73 (2012) [online] Available at: <<http://ssrn.com/abstract=2020527>> (accessed on 5 September 2013)

⁵³³ *Ibid.*, pp.72-73

⁵³⁴ *Ibid.*, p.136

⁵³⁵ *Ibid.*, p.137

⁵³⁶ *Ibid.*, p.138

to view whistle-blower programmes with distaste because they represent an implicit challenge to the regulatory Agency's effectiveness⁵³⁷. The emergence of a whistle-blower is a challenge to the legitimacy of a regulator, for information about fraud coming from a whistle-blower can suggest that regulators are not effectively monitoring their subject industry⁵³⁸. Whistle-blowers, notes Rapp, become competitors of the regulatory authorities; as a result, regulators tend to be unresponsive to whistle-blower complaints. A *qui tam* vehicle recognises that whistle-blowers' uneasy partnership, and sometimes outright competition with regulators can be leveraged for policy gain⁵³⁹.

Rapp proposes two fixes to Dodd-Frank Act: one would allow the payment of bounties even in cases producing nonmonetary sanctions⁵⁴⁰, and the other would empower whistle-blowers to pursue financial fraudsters even if the SEC remains inactive⁵⁴¹. However, Rapp remains sceptical about the ability of the Congress to adopt a more rigorous and effective *qui tam* provisions: "So far, legislators have shown more interest in creating even more holes in Dodd-Frank than filling in the ones already present in the statute. Wall Street may have to collapse in another bubble a decade from now before policymakers finally get around to adopting a more straightforward and effective whistle-blower reward program"⁵⁴².

Fisher *et al.* in *Privatizing Regulation: Whistleblowing and Bounty Hunting in the Financial Services Industries* (2001)⁵⁴³ give an enlightened vision of the regulatory development in the wake of the financial deregulation in the United States. Though written fifteen years ago the

⁵³⁷ *Ibid.*, p.139

⁵³⁸ *Ibid.*

⁵³⁹ *Ibid.*

⁵⁴⁰ *Ibid.*, pp.142-144

⁵⁴¹ *Ibid.*, pp.144-150

⁵⁴² *Ibid.*, p.152

⁵⁴³ Fisher, J. *et al.*, *supra* note 88 at 27

article is remarkable with its correct predictions of the upcoming financial turmoil and subsequent evolution of the models of enforcement. After financial modernisation legislation (Gramm-Leach-Bliley Act) was enacted in late 1999, the financial services industry in the United States has changed dramatically following deregulation and expansion in powers of financial institution. In keeping with that deregulation and expanded powers the regulatory landscape and enforcement mechanisms also had to change. As Fisher and his co-authors⁵⁴⁴ note, “while many applaud this legislation, others point to previous US experience where financial deregulation overwhelmed federal regulators and resulted in massive failures of financial institutions and, consequently, in huge bailouts.”⁵⁴⁵ For this reason the authors’ focus on the prospect of supplementing regulation with certain forms of private intervention. They analyse and compare whistle-blowing model with bounty hunting, finding that preoccupation of the whistle-blower laws with protection of employees from discharge or other acts of retaliation by the employer proved to be less successful than straightforward financial inducements to expose wrongdoing provided by bounty hunting regulation. Like whistle-blowers, bounty hunters conserve the government’s investigatory resources by identifying wrongdoers. Unlike whistle-blowers, bounty hunters frequently participate actively in apprehending and prosecuting offenders, thereby conserving governmental policing and prosecutorial resources as well. In order to encourage bounty hunters to play such an active role, the article argues, the financial rewards for bounty hunters must be substantial while protection from retaliation may not be necessary⁵⁴⁶.

⁵⁴⁴ Ellen Harshman, William Gillespie, Henry Ordower, Leland Ware and Frederick Yeager

⁵⁴⁵ *Ibid.*, p.117

⁵⁴⁶ *Ibid.*, pp.136-137

As authors conclude, the increased use of bounty hunting models in financial market regulation may become essential to enforcement. Bounty hunting, with its threat of significant monetary cost and potential individual liability, “compels managers to develop efficient internal legal compliance mechanisms”⁵⁴⁷. Thus bounty hunting, like whistleblowing, will have a deterrent effect and a powerful role to play in protecting the integrity of the financial markets, however, as articles notes, not to the exclusion of government enforcement. As Fisher *et al.* predict, “whistleblowing... remains largely supplemental and serendipitous [...] it is far less likely to play a material role in market regulation than is a well-designed array of bounty payment structures”⁵⁴⁸.

Besides mostly theoretical works analysing *qui tam* there are a few published empirical studies of *qui tam* litigation, the majority of those either dedicated to analysis of healthcare cases (though large and successful only), or utilise aggregated data published annually by the US Department of Justice. However some empirical studies remain outstanding both in their scope and ability to grasp the emerging trends. Thus, in *States, Statutes, and Fraud: An Empirical Study of Emerging State False Claims Acts (2006)*⁵⁴⁹ Barger *et al.* focus their efforts on identifying trends in development of the False Claims Act related legislation (with or without *qui tam* provisions) in US states. The authors present the first comprehensive survey of the structure and implications of states’ FCAs and *qui tam* provisions. The results are based on interviews with states’ officials charged with their enforcement. Interviewees were questioned regarding investigative resources allocated to false claims cases, the practical

⁵⁴⁷ *Ibid.*, p.143

⁵⁴⁸ *Ibid.*

⁵⁴⁹ Barger, J., Bucy, P., Eubanks, M. and Raspani, M., *States, Statutes, and Fraud: An Empirical Study of Emerging State False Claims Acts*, 80 **Tulane Law Review** 465-512 (2005-2006)

application of each individual state *qui tam* provision, the effectiveness of each provision, the impact of federal cases upon state cases, and coordination efforts between federal and state offices. The survey concludes with a data backed prediction that the number of statutes legislating private enforcement based on FCA, including those with *qui tam*, will steadily increase⁵⁵⁰.

The above mentioned prediction has proven to be correct, as shown in *States, Statutes, and Fraud: A Study of Emerging State Efforts to Combat White Collar Crime* (2010)⁵⁵¹ by Bucy and her co-authors⁵⁵², and in *States of Pay: Emerging Trends in State Whistle-blower Bounty Schemes* (2012)⁵⁵³ by Rapp. In a study conducted in 2009 Bucy and her co-authors analysed twenty-four jurisdictions which had false claims laws at the time⁵⁵⁴: California, Delaware, District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Louisiana, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, and Wisconsin⁵⁵⁵. Nebraska also had a false claims act at the time of the survey, but its law did not contain a *qui tam* provision⁵⁵⁶. In just two years, as shown by Rapp, an additional sixteen states have passed false claims laws: Arizona, Arkansas (no *qui tam* provision), Colorado, Connecticut, Iowa, Kansas (no *qui tam* provision), Maine (no *qui tam* provision), Maryland, Minnesota, Missouri (no *qui tam* provision), North Carolina, Oregon (no *qui tam* provision), South Carolina (no *qui tam*

⁵⁵⁰ *Ibid.*, pp.485-488

⁵⁵¹ Bucy, P. et al., *States, Statutes, and Fraud: A Study of Emerging State Efforts to Combat White Collar Crime*, 31 **Cardoso Law Review** 1523, 1524 (2010)

⁵⁵² Jonathan Diesenhaus, Marc S. Raspanti, Holly Chestnut, Katherine Merrell and Chad Vacarella

⁵⁵³ Rapp, G. Ch., *States of Pay: Emerging Trends in State Whistleblower Bounty Schemes*, 54 **South Texas Law Review** 53-79 (2012)

⁵⁵⁴ The authors correctly predicted that the number of states with *qui tam* provisions in their legislations would increase dramatically in the coming years

⁵⁵⁵ Bucy et al., *supra* note 537, app. A

⁵⁵⁶ *Ibid.*, app. B

provision), Utah (no *qui tam* provision), Vermont (no *qui tam* provision), and Washington⁵⁵⁷.

This brings the total number of jurisdictions with some form of false claims act to forty.

Alabama had also considered adopting a false claims act in 2001 and again in 2005, but has not done so, and no such bill was introduced in the latest legislative sessions, adds Rapp⁵⁵⁸.

Rapp made two contributions to the literature on bounty-reward schemes. First, he endeavoured to provide a typology and analysis of the rapidly developing world of state bounty schemes. Second, he analysed the way in which those bounty schemes were stimulated by federal law. Federal law, as Rapp points out, typically aims to change state laws in one of three ways: either by providing funding for states pursuing certain kinds of policy programmes, by conditioning funding for a variety of related matters on state compliance with a federal mandate, or by “pre-empting” state regulation through the enactment of a federal regulatory scheme⁵⁵⁹. However, with false claims act, for what may be the first time, as concludes Rapp, regular and on-going changes in state law were stimulated by the linkage between the strength of the federal FCA and parallel state law provisions⁵⁶⁰.

In the environmental context, Langpap and Shimshack (2010)⁵⁶¹ published a single recent empirical study examining public-private interaction by gauging the extent to which private enforcement efforts “crowd out” or “crowd in” public enforcement efforts.

⁵⁵⁷ Rapp, *supra* note 539, Table 1

⁵⁵⁸ *Ibid.*, p.62

⁵⁵⁹ *Ibid.*, pp.61-66

⁵⁶⁰ *Ibid.*, p.74

⁵⁶¹ Langpap, Ch., and Shimshack, J.P., *Private Citizen Suits and Public Enforcement: Substitutes or Complements?* 59 *Journal of Environmental Economics and Management* 235, 237–38 (2010)

Kesselheim, Studdert and Mello in *Whistle-Blowers' Experiences in Fraud Litigation Against Pharmaceutical Companies* (2010)⁵⁶² analyse profiles of *qui tam* relators who won large recoveries in healthcare cases. Their research documents the outcomes of major enforcement actions and describes the schemes, defendants, and whistle-blowers involved. It focuses on the scope and characteristics of *qui tam* fraud litigation, as well as on the whistle-blowers, their motives and circumstances under which they became *qui tam* relators.

As the authors note, federal regulators have aggressively prosecuted health care fraud since the early 1990s, and were successful in recovering billions of dollars. Nearly all major successful cases were *qui tam* actions, which involved whistle-blowers with inside knowledge of the allegedly illegal schemes. The authors obtained an inventory of unsealed federal *qui tam* litigation targeting pharmaceutical companies that was resolved between 1996 and 2005 from the US Department of Justice and gathered further information from publicly available sources. Among 379 cases, \$9.3 billion was recovered, with more than \$1.0 billion paid to whistle-blowers⁵⁶³. Case frequency peaked in 2001, but annual recoveries increased sharply from 2002 to 2005⁵⁶⁴. Whistle-blowers were frequently executives or physicians, and 75% were employees of defendant organisations⁵⁶⁵. The 13 (4%) cases against pharmaceutical companies accounted for \$3.6 billion (39%) of total recoveries⁵⁶⁶.

Although the relators in the sample (42 persons in total) all ended up using the *qui tam* mechanism, only six specifically intended to do so, note the authors. The others fell into the

⁵⁶² Kesselheim, A. S., Studdert, D. M., and Mello, M. M., *Whistle-Blowers' Experiences in Fraud Litigation Against Pharmaceutical Companies*, 362 **The New England Journal of Medicine** 1832 (2010) [online] Available at: <<http://www.nejm.org/doi/full/10.1056/NEJMs0912039#t=article>> (accessed on 30 April 2014)

⁵⁶³ *Ibid.* [online]

⁵⁶⁴ *Ibid.* [online]

⁵⁶⁵ *Ibid.* [online]

⁵⁶⁶ *Ibid.* [online]

qui tam process after seeking lawyers for other reasons (e.g., unfair employment practices) or after being encouraged to file a suit by family or friends. Remarkably, every relator interviewed during that research stated that the financial bounty offered under the federal statute had not motivated his or her participation in the *qui tam* lawsuit. Reported motivations coalesced around four non-mutually exclusive themes: integrity, altruism or public safety, justice, and self-preservation.

All relators in the sample for the research received a share of the financial recovery which amount ranged from \$100,000 to \$42 million, with a median of \$3 million (net values, in 2009 dollars)⁵⁶⁷. The settlements helped alleviate some of the financial and nonfinancial costs of the litigation, but the prevailing sentiment among the participants was that the payoff had not been worth the personal cost. However, concludes the authors, despite the negative experiences and dissatisfaction with levels of financial recovery, most relators still felt that what they did was important for ethical and other psychological or spiritual reasons.

Feldman and Lobel in *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties and Protections for Reporting Illegality* (2010)⁵⁶⁸ give a further contribution to the study of individual motives to report wrongdoing (“social enforcement”, as authors choose to define it), as well as the changing societal norms applied to such activism. As authors state, “social enforcement” is becoming a key feature of regulatory policy, when statutes increasingly rely on individuals to report misconduct, but the incentives they provide to encourage such enforcement vary significantly. “Despite the growing interest in the legal

⁵⁶⁷ *Ibid.* [online]

⁵⁶⁸ Feldman, Y. and Lobel, O., *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties and Protections for Reporting Illegality*, 88 **Texas Law Review** 1151, 1161 (2010)

academy and practice in new governance approaches to law and policy, the study of individual motivation and behaviour as directly connected to legal design is in its nascent stages,” note co-authors⁵⁶⁹.

The study contributes to the empirical literature about individual and group behaviour, including debates on motivational crowding-out, trust, misperception of norms and attribution and the ability of individuals to rationally balance the costs and benefits of their own decisions, and to assess the behaviour and interests of others⁵⁷⁰. Using a series of experimental surveys of a representative panel of over 2000 employees, Feldman and Lobel compare the effect of different regulatory mechanisms - monetary rewards, protective rights, positive obligations, and liabilities - on individual motivation and behaviour. By exploring the interplay between internal and external enforcement motivation, these experiments provide some insights into the comparative advantages of legal mechanisms that incentivise compliance and “social enforcement”⁵⁷¹.

At the theoretical level, the study contributes to several strands of inquiry, including motivational crowding-out effects, framing biases, the existence of a “holier-than-thou” effect, and gender differences among social enforcers⁵⁷².

At the policymaking level, the study offers practical findings about the costs and benefits of different regulatory systems, including findings about inadvertent counterproductive effects

⁵⁶⁹ *Ibid.*, p.45

⁵⁷⁰ See Anderson, E., (1995). *Value in Ethics and Economics*, Harvard University Press; Raz, J., (1986). *The Morality of Freedom*, Clarendon Press; Sunstein, C. R. *et al.*, *Predictably Incoherent Judgments*, 54 **Stanford Law Review** 1153 (2002)

⁵⁷¹ Feldman and Lobel, *supra* note 568 at 123, pp. 45-49

⁵⁷² *Ibid.*, pp. 16-24

of certain legal incentives: they indicate that in some cases offering monetary rewards to whistle-blowers will lead to less, rather than more, reporting of illegality⁵⁷³. The study implies that no one-size-fits-all policy design exists, but rather policymakers must evaluate the full scope of psychological and situational factors in order to design the most efficient incentives structures⁵⁷⁴. First, policymakers must assess the nature and severity of the anticipated conduct. Where levels of moral outrage are expected to be low, financial rewards will likely be a decisive factor, and the inquiry may shift to discovering the true price tag of the reporting behaviour⁵⁷⁵. For inherently offensive misconduct, policy design must take a more nuanced approach that integrates the moral dimension of the situation. In such cases, where the informant is expected to have a greater ethical stake in the outcome, regulation must fully appeal to the informant's sense of duty. This may mean that "financial incentives are not only unnecessary but are counterproductive and offset internal motivations to report" wrongdoing⁵⁷⁶.

The study demonstrates that informed policymakers must factor in the possibility that informants may underestimate the role of financial incentives in their own decision to report: whereas others are perceived as reporting mainly for money, people tend to perceive their own social enforcement actions as more ethically driven⁵⁷⁷. Moreover, in choosing among the various mechanisms available, the study demonstrates that stigma levels attached to reporting wrongdoing vary along the selected mechanism⁵⁷⁸. Concluding, Feldman and Lobel note that policymakers must consider the target potential individuals for which the regulatory

⁵⁷³ *Ibid.*, pp.26, 36-38

⁵⁷⁴ *Ibid.*, pp.41-42

⁵⁷⁵ *Ibid.*, pp.43-44

⁵⁷⁶ *Ibid.*, p.44

⁵⁷⁷ *Ibid.*, pp.28-31, 40-41

⁵⁷⁸ *Ibid.*, pp.24-25, 38

mechanisms are provided. In particular, gender differences are highly pronounced in the realm of whistleblowing and further research should consider the reasons for which women care much more than men about anti-retaliation protections⁵⁷⁹.

Broderick in *Qui Tam Provisions and the Public Interest: An Empirical Analysis* (2007)⁵⁸⁰ used aggregated data on filings and impositions, as published annually by US Department of Justice, to draw conclusions about workings of *qui tam* regime. These corroborated by data conclusions she views as the main contribution to the subject by her research. “Unlike previous articles on [*qui tam*], which have almost completely limited their analysis of this question to a theoretical discussion of the value of the *qui tam* provision of the Federal FCA, she writes, this Note uses an empirical approach to study both the Federal Act and similar state acts”⁵⁸¹.

Based on such analysis, her work argues that while *qui tam* provisions lead to frivolous suits, they still serve the public interest through both enhanced detection and deterrence, although the degree to which they serve this interest is not nearly as great as proponents argue⁵⁸². Further, it contends that based on the experiences of both federal and state *qui tam* provisions, these provisions should be amended to minimise the number of frivolous suits and capitalise on the most valuable aspects of *qui tam* provisions⁵⁸³. Specifically, she argues, that on the federal level the Attorney General should retain greater control over *qui tam* actions even when he/she does not intervene⁵⁸⁴, and their use should be limited to medical

⁵⁷⁹ *Ibid.*, pp.34-36, 44-47

⁵⁸⁰ Orsini Broderick, Ch., Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 **Columbia Law Review** 949-1001 (2007)

⁵⁸¹ *Ibid.*, p.950

⁵⁸² *Ibid.*, pp.971, 980-981, 987

⁵⁸³ *Ibid.*, pp.997

⁵⁸⁴ *Ibid.*, p.997

assistance claims⁵⁸⁵; and on a state level that greater fact-finding and systematic data collection need to be undertaken, both before and after enacting a *qui tam* provision, so that state *qui tam* provisions can be tailored to the specific needs of each individual state⁵⁸⁶.

More empirical data about the identities and actions of *qui tam* relators can be found in reports published by National Whistle-blowers Center, such as *Impact of Qui Tam Laws on Internal Corporate Compliance* (2010)⁵⁸⁷. This report, finding most relators report fraud internally before filing *qui tam* actions⁵⁸⁸, however, suffers from serious methodological shortcomings: while publishing results of analysis of 107 cases between 2007 and 2010, it considers only published opinions in which relator asserted retaliation claim under relevant provision of FCA⁵⁸⁹.

Relevant empirical data and initial set of conclusions about Department of Justice enforcement strategy in respect of *qui tam* cases are available in a working paper *Coordinated Private and Public Enforcement of Law: Deterrence under Qui Tam* (2010)⁵⁹⁰, prepared by David Kwok. Some descriptive statistics regarding the role of more experienced *qui tam* relator firms, collected by the same researcher, was published in *Does Private Enforcement Attract Excessive Litigation? Evidence from the False Claims Act* (2012)⁵⁹¹.

⁵⁸⁵ *Ibid.*, p.998

⁵⁸⁶ *Ibid.*, pp.999-1000

⁵⁸⁷ National Whistleblowers Center, *Impact of Qui Tam Laws on Internal Corporate Compliance* (2010), [online] Available at: <http://www.whistleblowers.org/index.php?option=com_content&task=view&id=1169> (accessed 18 December 2012)

⁵⁸⁸ *Ibid.*, p.4

⁵⁸⁹ 31 U.S.C. § 3730(h) (2006)

⁵⁹⁰ Kwok, D., *Coordinated Private and Public Enforcement of Law: Deterrence Under Qui Tam* (Feb. 18, 2010) (unpublished manuscript), [online] Available at: <https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=ALEA2010&paper_id=375> (accessed on 17 December 2013)

⁵⁹¹ Kwok, D., *Does Private Enforcement Attract Excessive Litigation? Evidence from the False Claims Act*, 41 **Public Contract Law Journal** 10 (2012) [online] Available at: <<http://ssrn.com/abstract=1832934>> (accessed on 17 December 2013)

Among those who first provided a well-documented critique of the assumed efficiency of *qui tam* provisions was professor Kovacic. In *Whistle-blower Bounty Lawsuits as Monitoring Devices in Government Contracting* (1996)⁵⁹² he points out to two closely related disadvantages of the enforcement structure established by the False Claims Act. First, attempting to curb agency costs in government procurement by deputising private individuals can create serious agency problems of its own. *Qui tam* relators may not invariably act to maximise taxpayer interests. In the absence of comparative data on the agency costs of the *qui tam* process with the agency costs of alternative monitoring techniques it is impossible to give a proper evaluation to the whistleblower bounty as a monitoring device. The second disadvantage is the potential of *qui tam* monitoring to impede the development of the purchaser-supplier partnership and the government's adoption of "commercial practices" that are key aims of a procurement reform⁵⁹³.

In *The Civil False Claims Act As a Deterrent to Participation in Government Procurement Markets* (1998)⁵⁹⁴ Kovacic noted that "compared with legal regimes used to police fraud in commercial contracting, the Civil False Claims Act creates a distinctly powerful mechanism to constrain seller conduct"⁵⁹⁵. The CFCA enforces an unusually wide range of substantive requirements, establishes comparatively lesser burdens that prosecuting parties must bear in establishing liability for fraud, widely decentralises the decision to prosecute, and punishes violations with a combination on minimum monetary penalties for each offence and treble

⁵⁹² Kovacic, W., *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 **Loyola of Los Angeles Law Review** 1799-1858 (1995-1996)

⁵⁹³ *Ibid.*, pp. 1806-1808

⁵⁹⁴ Kovacic, W., *The Civil False Claims Act As a Deterrent to Participation in Government Procurement Markets*, 6 **Supreme Court Economic Review** 201 (1998)

⁵⁹⁵ *Ibid.*, pp. 204, 217-220

damages for actual harm. As a group, Kovacic argues, they increase the risk that a firm's failure to fulfil contractual promises to the government will be challenged as fraudulent and will be a subject to severe punishment⁵⁹⁶. The article reports the results of a survey to assess the impact of CFCA oversight on supplier behaviour. A total of 40 firms representing a mix of traditional government contractors responded to questions concerning the effects of CFCA requirements. The surveyed firms indicated that contractors regard CFCA oversight as costly, substantial burden of doing business with the government. These results, concludes Kovacic, "suggest CFCA is likely to impede efforts to induce commercial firms to expand their relationships with government purchasing agencies"⁵⁹⁷.

It is worth noting that from the perspective of the years, which have passed since the articles first appeared in public domain none of professor, Kovacic's predictions have materialised.

Scholarly attention to the flaws of private enforcement in general, and *qui tam* enforcement in particular, has focused primarily on the misalignment between incentives that drive private attorneys general and relators and the public good. Gilles (2000)⁵⁹⁸ and Beck (2000)⁵⁹⁹ highlighted the risks of overenforcement by private attorneys in civil rights cases. Thomson (2000)⁶⁰⁰ raised concerns of prosecutorial error in environmental protection cases, bringing evidence of under enforcement by private agencies, when the private enforcers fail to bring suits that would benefit the common good. Ruhnka, Gac and Boerstler (2000)⁶⁰¹ argue that

⁵⁹⁶ *Ibid.*, pp. 223-235

⁵⁹⁷ *Ibid.*, p. 205

⁵⁹⁸ Gilles (2000), *supra* note 517 at 115

⁵⁹⁹ Beck (2000), *supra* note 4 at 8

⁶⁰⁰ Thompson, Jr., B.H., *The Continuing Innovation of Citizen Enforcement*, **University of Illinois Law Review** 185-206 (2000)

⁶⁰¹ Ruhnka, J. C., Gac, E. J., and Boerstler, H., *Qui Tam Claims: Threat to Voluntary Compliance Programs in Healthcare Organizations*, 25 **Journal of Health Politics, Policy and Law** 283, 284 (2000)

the *qui tam* provisions of the FCA have the effect of encouraging employees not to report misbillings uncovered in internal compliance programmes to their employers for correction, but instead to use such information to file *qui tam* lawsuits against their employers in order to share in the recoveries to the government.

Brodley (1995)⁶⁰² warned of misdirected resources in antitrust litigation sparked by private enforcers, the same concern in respect of the securities litigation was expressed by Grundfest (1994)⁶⁰³. Stewart and Sunstein (1982)⁶⁰⁴ argued for judicial control to limit “the perverse incentives that drive private enforcers”⁶⁰⁵. Blomquist (1988)⁶⁰⁶ and Stephenson (2005)⁶⁰⁷, on the other hand, advocated executive branch control to prevent private enforcers from overreaching. The alleged disruptive impact of the False Claims Act on the healthcare has been given a detailed analysis in Bucy (2000)⁶⁰⁸.

Baruch, Boese and Johnson (2011)⁶⁰⁹ decry in particular the lack of express provisions in the FCA prohibiting awards to private employees with a duty to report fraud, such as in-house lawyers, auditors, and compliance officers. Remarkably, more than a decade earlier Ruhnka *et al.* (2000) raised relevant concern: “The prospect of corporate inside legal counsel or

⁶⁰² Brodley, J.E., *Antitrust Standing in Private Merger Cases: Reconciling Private Incentives and Public Enforcement Goals*, 94 **Michigan Law Review** 1-22 (1995)

⁶⁰³ Grundfest, J.A., *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission’s Authority*, 107 **Harvard Law Review** 961-970 (1994)

⁶⁰⁴ Stewart, R.B. and Sunstein, C.R., *Public Programs and Private Rights*, 95 **Harvard Law Review** 1193 (1982)

⁶⁰⁵ *Ibid.*, p.1193

⁶⁰⁶ Blomquist (1988), *supra* note 435 at 106

⁶⁰⁷ Stephenson, M.C., *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 **Virginia Law Review** 93-106 (2005)

⁶⁰⁸ Bucy, P. H., *The Path From Regulator to Hunter. The Exercise of Prosecutorial Discretion in the Investigation of Physicians at Teaching Hospitals*, 44 **Saint Louis University Law Journal** 3, 46-48 (2000)

⁶⁰⁹ Client Memorandum, Fried, Frank, Harris, Shriver & Jacobson LLP, *The SEC’s Whistleblower Program: What the SEC Has Learned from the False Claims Act About Avoiding Whistleblower Abuses—and What FCA Enforcement Stands to Learn from the SEC* (27 June 2011) [online] Available at: <<http://www.friedfrank.com/index.cfm?pageID=25&itemID=6388>> (accessed on 27 November 2013)

internal audit staff who are charged with discovering misbilling practices filing a *qui tam* suit against their employer ... raises serious issues of breach of fiduciary duties, violation of nondisclosure and confidentiality agreements, and violations of accountant-client or attorney-client relationships.”⁶¹⁰

Dayna Matthew in *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud* (2007)⁶¹¹ analyses the effects that the availability of private enforcement brings on the government’s incentives to enforce the regulations, and takes a law and economics approach to explore some of the costs that arise when governments rely on private enforcement to accomplish the goals of public law. Her analysis focuses on *qui tam* enforcement under the Civil False Claims Act, and is based on a body of empirical data that demonstrates the expansive role private *qui tam* relators have played in enforcing Medicare and Medicaid fraud and abuse laws. As professor Matthew notes, nearly all of the largest settlements and judgments announced against pharmaceutical defendants during the previous three years have involved a *qui tam* relator⁶¹². In 1987, over ninety per cent of FCA actions were filed by the government alone, but by 2005, nearly eighty per cent of all new FCA actions were filed by private *qui tam* litigants⁶¹³.

The article examines the fundamental divergence between private and public incentives in FCA prosecutions. “The concept of moral hazard, argues Matthew, provides substantial explanatory power to reconceptualise the costs and benefits of private enforcement”⁶¹⁴. The

⁶¹⁰ Ruhnka *et al.*, *supra* note 587 at 130, p.301

⁶¹¹ Matthew, D.B., *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud*, 40 **University of Michigan Journal of Law Reform** 281-339 (2007)

⁶¹² *Ibid.*, p.284

⁶¹³ *Ibid.*

⁶¹⁴ *Ibid.*, p. 282

availability of private enforcers creates significant opportunities for public prosecutors to over enforce. Additionally, the reduction in short term risk causes public prosecutors to reduce the care that typically controls their exercise of prosecutorial discretion.

As Matthew's analysis shows, the government's abdication of authority under the FCA results in over-prosecution and a harmful reduction in the government's exercise of caution in the selection and pursuit of the selected cases. The analysis of pharmaceutical cases, concludes Matthew, proves that privatisation of FCA claims is costly. It has hindered the orderly development of well-reasoned substantive law and has clearly distorted the market incentives and relationships between industry actors. Due to the moral hazard problem that arises from that privatisation, FCA claims increasingly attract plaintiffs with questionable motives who advance and inadvertently make bad law, which supplants the reasoned regulatory regime that should govern government contractors' conduct⁶¹⁵.

Further critique of the *qui tam* provisions is published in *The Ubiquitous False Claims Act: The Incongruous Relationship Between a Civil War Era Fraud Statute and the Modern Administrative State* (2008)⁶¹⁶, by Harkins, a practicing lawyer, who criticises private enforcement from the perspective of healthcare providers. He argues that False Claims Act and current Medicare and Medicaid statutes are incompatible from the legal point of view. Rise in administrative law system and administrative bodies turned agencies into "a veritable fourth branch of the government"⁶¹⁷. With the growth of the administrative state, notes

⁶¹⁵ *Ibid.*, pp. 306-332

⁶¹⁶ Harkins, M.J., *The Ubiquitous False Claims Act: The Incongruous Relationship Between a Civil War Era Fraud Statute and the Modern Administrative State*, 1 **Saint Louis University Journal of Health Law & Policy** 131-174 (2007-2008)

⁶¹⁷ *Ibid.*, p. 144

Harkins, has come a concomitant increase in the federal government's "economic role in national life... and with it the opportunities for those receiving government funds" to violate one or more of the innumerable regulations governing entitlement to provide government benefits⁶¹⁸.

But, as argues Harkins, in 1863 the "fourth branch of the government" did not exist, and thus was not a source of federal law when the FCA was adopted. Consequently, legitimate questions arise about whether or when a claim for payment can be "false and fraudulent" under the FCA based on government contractor's failure to comply with administrative regulatory standards of a type unknown to the Civil War Congress (e.g., regulating the production process or quality)⁶¹⁹. It is fair to say that the question whether violation of such a regulation makes a subsequent claim for payment false or fraudulent is a question that never would have occurred to the FCA's authors, states Harkins⁶²⁰. Whether the contractor adhered to appropriate or reasonable manufacturing standards would have been irrelevant to those who passed the FCA.

In 1863, argues Harkins, the development of the administrative system that occurred in the second half of the XX century could not have been foreseen. Nor could congressionally imposed limits on judicial review of administrative action have been anticipated⁶²¹.

As Harkins points out, Medicare and Medicaid benefits generally are provided through private contractors (known as providers), who are paid pursuant to the Medicare and Medicaid

⁶¹⁸ Boese (2011), *supra* note 92 at 28, pp. 1-11

⁶¹⁹ Harkins, *supra*, pp. 144-145

⁶²⁰ *Ibid.*

⁶²¹ *Ibid.*, p.146

statutes and accompanying regulations⁶²². These statutes and regulations have been described by the Supreme Court as “Byzantine” texts that are “among the most intricate ever drafted by Congress”⁶²³, describing Medicare as a “massive, complex health and safety program... embodied in hundreds of pages of statutes and thousands of pages of often interrelated regulations”⁶²⁴. Healthcare providers daily navigate a “morass of bureaucratic complexity”, submitting thousands of claims a day to the Medicare and Medicaid programmes⁶²⁵. If providers cross one of the lines in these programmes’ “impenetrable texts”⁶²⁶, they expose themselves to a potential liability under the FCA. And the financial consequences of running afoul of the FCA, warns Harkins, can be extraordinary⁶²⁷.

In conclusion, Harkins points out to judicial discomfort and confusion about applying the FCA to heavily regulated entities⁶²⁸. The problem is that “*qui tam* relators are... less likely than is the government to forgo an action arguably based on a mere technical noncompliance with reporting requirements that involved no harm to the public fisc”⁶²⁹. The proposed solution is to reform FCA so as to curb activity of *qui tam* relators⁶³⁰.

von Spakovsky and Walsh in *Correcting False Claims about the New False Claims Act Legislation* (2009)⁶³¹ present a systemic critique of the freshly enhanced FCA *qui tam* provisions⁶³² adding some new arguments to the earlier accusations voiced by the critics of

⁶²² 42 U.S.C. & 1395g, (2000)

⁶²³ *Schweiker v Grey Panthers*, 453 U.S. 34, 43 (1981)

⁶²⁴ *Shalala v. Ill. Council on Long Term Care, Inc.*, 529 U.S. 1, 13 (2000)

⁶²⁵ *Herweg v. Ray*, 455 U.S. 265, 279 (1982) Burger, C.J., dissenting

⁶²⁶ *Rehabilitation Association of Virginia, Inc v. Kozlowski*, 42 F.3d 1444, 1450 (4th Cir. 1994)

⁶²⁷ Harkins (2008), *supra* note 602 at 133, p.159

⁶²⁸ *Ibid.*, p.167

⁶²⁹ *Hughes Aircraft Co. v. US ex rel. Schumer*, 520 U.S. 939, 949 (1997)

⁶³⁰ Harkins (2008), *supra* note 602 at 133, pp. 169-174

⁶³¹ von Spakovsky and Walsh (2009), *supra* note 265 at 67

⁶³² Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21 (2009)

private enforcement that *qui tam* as a litigation regime run amok and has become a “cottage industry,” a “legal gold rush,” and a “great American giveaway” to an undeserving alliance of “bounty-seeking” and increasingly “professional” relators and an ever more specialised *qui tam* plaintiffs’ bar⁶³³.

von Spakovsky and Walsh argue, that the FCA *qui tam* provisions:

- Reduces the primacy in FCA litigation of government prosecutors, investigators, and other disinterested professionals working in the public interest;
- Manufactures needless litigation brought by private plaintiffs and plaintiffs' lawyers who are enticed by prospects of striking it rich through FCA lawsuits, not protecting the American taxpayer;
- Increases the number of lawsuits and potential targets of such lawsuits by allowing punitive FCA actions to be brought against private entities (such as hospitals, universities, and other non-governmental organisations) just because they have received unrelated federal funds;

⁶³³ For a vociferous critique see Kolis, M.L., Comment, *Settling for Less: The Department of Justice’s Command Performance Under the 1986 False Claims Amendments Act*, 7 **Administrative Law Journal of the American University** 409-441 (1993) (“[M]any *qui tam* suits are brought by vengeful, disgruntled former employees of government contractors”); Thompson M., *Stealth Law: Whistleblowers and Their Lawyers Are Maneuvering To Cash in on Military Fraud*, **California Lawyer**, Oct. 1988, pp. 33, 33–34 (noting DOJ contention that many *qui tam* suits are based on “disgruntled employee’s say-so”); Waldman, M., *Time to Blow the Whistle?*, **National Law Journal**, Mar. 25, 1991, pp. 13- 14 (“Not surprisingly, many of the recent spate of *qui tam* lawsuits can be traced to disgruntled employees. A disturbing number of recent *qui tam* actions, for example, have arisen after companies instituted layoffs or terminated unproductive employees”); Loucks, M.K., *Rewarding the Whistleblowers Under the False Claims Act: The Great American Giveaway*, 15 **Healthcare Fraud Report** (BNA) No. 2, (26 January 2011) (“A whistleblower who seeks advice from private counsel who himself stands to gain from the False Claims Act litigation by sharing in the recovery will most likely be advised not to report the matter to corporate compliance” (pp. 102-103); Weinberg, N., *Envy Engines*, **Forbes**, 14 March 2005, p.94 (quoting prominent defence lawyer describing *qui tam* lawsuits as “envy engines that bring out competitors, fired office workers, ex-spouses and mischievous patients”); Editorial, *False Claims Gold Rush*, **Wall Street Journal**, May 2, 2008, at A14 (“Welcome to the legal gold rush occurring under the cover of ‘reforming’ the False Claims Act”)

- Unfairly permits the government to assert claims that would otherwise be time-barred by effectively circumventing ("tolling") the statute of limitations⁶³⁴ by relating back the government's intervention to the date that the individual plaintiff filed the original *qui tam* complaint, thereby undermining the ability of a defendant to defend himself;
- Greatly increases the number of individuals and organisations that can bring secondary lawsuits (as well as the number of individuals who may be made defendants in those lawsuits) claiming that they were retaliated or discriminated against even if they took no steps to actually bring an FCA lawsuit;
- Allows the Department of Justice to provide information obtained using the federal government's law enforcement authority and resources to private parties for use in FCA suits against other private parties⁶³⁵.

Some authors add critique or anecdotal evidence. Kolz (2010)⁶³⁶ describes efforts of "professional" and "serial whistle-blower", who has filed multiple *qui tam* lawsuits. Krause (2002)⁶³⁷ argues that "meritless" lawsuits are to blame for increase in volume of *qui tam* litigation. According to Rich (2008)⁶³⁸, "the FCA encourages the government too often to stand by and allow relators to exercise nearly complete prosecutorial discretion in their *qui tam* actions."⁶³⁹ Other works, while considering overall desirability of *qui tam* legislation, nevertheless suggest it must be reformed to the point it may be completely emasculated⁶⁴⁰.

⁶³⁴ Statutory imposed time limits on filing lawsuits

⁶³⁵ von Spakovsky and Walsh (2009), *supra* note 265 at 67

⁶³⁶ Kolz, A. *The Professional*, **American Lawyer**, 1 June 2010, p. 28

⁶³⁷ Krause, J.H., "*Promises to Keep*": *Healthcare Providers and the Civil False Claims Act*, 23 **Cardozo Law Review** 1363-1383 (2002)

⁶³⁸ Rich, M., *Prosecutorial Indiscretion: Encouraging the Department of Justice To Rein in Out-of- Control Qui Tam Litigation Under the False Claims Act*, 76 **University of Cincinnati Law Review** 1233 (2008)

⁶³⁹ *Ibid.*, p. 1238

⁶⁴⁰ Kunich, J.C., *Qui Tam: White Knight or Trojan Horse*, 33 *The Air Force Law Review* 31 (1990); McGreal, P. E. and DeeDee Baba, *Applying Coase to Qui Tam Actions Against the States*, 77 **Notre Dame Law Review** 87 (2001); Williams, V.J., *Dead Men Telling Tales: A Policy-Based Proposal for Survivability of Qui Tam Actions Under the*

Focusing on the relators and their counsel such pervasive line of criticism advances what Engstrom (2012) called a “supply-side” critique of *qui tam* enforcement⁶⁴¹.

In an article on findings of his research Engstrom summarises the typical critique cast on *qui tam* relators and their specialised lawyers⁶⁴².

Most often opponents of *qui tam* regard relators as vengeful former employees who use the FCA as leverage in garden-variety employment disputes, or as opportunistic profit-seekers who deliberately bypass internal compliance systems in the rush to collect bounties, sit on evidence of wrongdoing to let the meter run on damages before bringing suit, or (in the case of attorney-relators) undercut the giving and receiving of legal advice by using in *qui tam* suits the sort of information which falls within the attorney-client privilege⁶⁴³.

Another common contention is that profit-motivated relators have little useful information not already known to the government, and instead file claims that are “parasitic” on already-existing public investigations or enforcement efforts. Parasitism concerns emerge most directly in cases brought by government employees who learn of fraud while on the job, and

Civil False Claims Act, 83 **Nebraska Law Review** 1073 (2005); Broliier, J.T., Note, *Mutiny of the Bounty: A Moderate Change in the Incentive Structure of Qui Tam Actions Brought Under the False Claims Act*, 67 **Ohio State Law Journal** 693 (2006); Chandler, T.D., Comment, *Lawyer Turned Plaintiff: Law Firms and Lawyers as Relators Under the False Claims Act*, 35 **Houston Law Review** 541 (1998); Estrada, L., Case Note, *An Assessment of Qui Tam Suits by Corporate Counsel Under the False Claims Act: United States ex rel. Doe v. X Corp.*, 7 **George Mason Law Review** 163 (1998); Frieden, Ch. C., Comment, *Protecting the Government's Interests: Qui Tam Actions Under the False Claims Act and the Government's Right to Veto Settlements of Those Actions*, 47 **Emory Law Journal** 1041 (1998); Harris, T.L., Note, *Alternate Remedies & the False Claims Act: Protecting Qui Tam Relators in Light of Government Intervention and Criminal Prosecution Decisions*, 94 **Cornell Law Review** 1293 (2008); LaSalle, F., Comment, *The Civil False Claims Act: The Need for a Heightened Burden of Proof as a Prerequisite for Forfeiture*, 28 **Akron Law Review** 497 (1995); Phelps, L.M., Note, *Calling Off the Bounty Hunters: Discrediting the Use of Alleged Anti-Kickback Violations to Support Civil False Claims Actions*, 51 **Vanderbilt Law Review** 1003 (1998)

⁶⁴¹ Engstrom (2012), *supra* note 441 at 105, p.1275

⁶⁴² *Ibid.*

⁶⁴³ *Ibid.*, pp. 1275-1277

courts and commentators have vigorously disagreed about the propriety of allowing such suits under the FCA⁶⁴⁴.

A further tenet of relator-focused critiques focuses on organisational and entity relators who deploy the FCA to seek a competitive business advantage or to further an ideological or other agenda⁶⁴⁵.

This latter example relates to a final and critically important tenet of the supply-side critique of relators: the claim that an increasing share of *qui tam* litigation is the work of so-called “professional” relators who lack the traditional insider status of *qui tam* whistle-blowers and instead build cases through information derived from private investigative work targeting present and past company employees or publicly available sources, including requests based on Freedom of Information Act in respect of government agencies⁶⁴⁶.

The other part of the “supply-side” critique is focused not on relators, but rather on an increasingly sophisticated and specialised *qui tam* relators’ bar⁶⁴⁷. At present, several dozen law firms -- and, according to various estimates, roughly 200 lawyers⁶⁴⁸ -- advertise that they do mostly relator-side representations or even particular types of FCA claims, such as healthcare fraud. Most relator-side practice proceeds on a contingent fee basis, with the lawyer’s cut often set at 40 per cent⁶⁴⁹.

⁶⁴⁴ *Ibid.*, p. 1277

⁶⁴⁵ *Ibid.*, p. 1278

⁶⁴⁶ *Ibid.*, pp. 1279

⁶⁴⁷ *Ibid.*, p. 1281

⁶⁴⁸ Weinberg, *supra* note 323, pp. 90-91

⁶⁴⁹ Bario, D., *A Whistleblower and Its “Pit Bull”*, **National Law Journal**, 7 February 2011, p.n1 (Quoted in Engstrom (2012), *supra* note 441 at 105, p. 1280)

The emergence of an organised relators' bar has stoked complaints that *qui tam* litigation is too lawyer-driven. The organised relators' bar is accused of "trolling for unhappy company employees to serve as whistleblowing relators."⁶⁵⁰ They are also viewed as "filing mills," bringing large volumes of *qui tam* claims with an aim to preserving a right to a portion of an eventual recovery, but with no intention of assisting the Department of Justice⁶⁵¹.

Specialised *qui tam* lawyers are also blamed for their role in developing so-called "certification" claims⁶⁵².

A final tenet of the "supply-side" critique taps into longstanding concerns about clientelism between public and private enforcers in private enforcement regimes. Just as relator-side law firm websites advertise their experience in *qui tam* enforcement, they also frequently note the past experience of their lawyers with relevant government agencies. Such claims have fuelled the suspicion that *qui tam* revival has led to the development of an organised relators' bar made up of former government lawyers who previously litigated False Claims Act cases, and so are especially effective at "enticing" the Department of Justice to intervene in *qui tam* cases⁶⁵³.

By carrying out the first large-scale empirical study⁶⁵⁴ of the *qui tam* regime Engstrom's analysis focuses on three main areas:

⁶⁵⁰ Engstrom (2012), *supra*, p. 1283

⁶⁵¹ *Ibid.*, p. 1284

⁶⁵² The claims in which a relator alleges that a federal funding recipient falsely implied certification of compliance with a separate statutory or regulatory requirement as a condition of receiving federal funds, rendering "false" any claim made for that funding

⁶⁵³ *Ibid.*, p. 1285

⁶⁵⁴ An original data set encompassed more than 4,000 unsealed *qui tam* lawsuits filed between 1986 and 2011 (*Ibid.*, p. 1249)

- The role of specialised enforcers (including repeat relators, the organised *qui tam* relators' bar, and former Department of Justice insiders) in the *qui tam* litigation;
- Evidence of clientelism and capture among specialised enforcers;
- Whether or not the role of enforcer specialisation has changed over time.

The survey's core findings provide a more nuanced portrait of *qui tam* litigation.

Contrary to a popular critique, specialised *qui tam* firms appear to play a positive role in the system, enjoying higher litigation success rates and surfacing larger frauds compared to less experienced litigants⁶⁵⁵. As Engstrom notes, "the story for repeat relators -- meaning the plaintiffs themselves -- is more complicated"⁶⁵⁶, but his conclusion is largely the same⁶⁵⁷. Repeat relators win less often than one-shotters, but they offset lower win rates by obtaining substantially larger sums ("impositions") when they succeed⁶⁵⁸. "Critics of 'professional' relators, it seems, have it mostly wrong", concludes Engstrom⁶⁵⁹.

The law review literature containing studies, which addressed **the constitutionality of the *qui tam*** mechanism is particularly vast. The academic discussion was sparked in 1986, after the Congress amended the False Claims Act to enhance its *qui tam* provisions, and gradually faded away when all attempts to challenge constitutionality of the revised FCA in courts had been lost⁶⁶⁰, and the legislators had clearly shown their intent to further employ the *qui tam*

⁶⁵⁵ *Ibid.*, pp. 1288-1297

⁶⁵⁶ *Ibid.*, p. 1249

⁶⁵⁷ *Ibid.*, pp. 1298-1305

⁶⁵⁸ *Ibid.*, pp. 1306-1308

⁶⁵⁹ *Ibid.*, p. 1250

⁶⁶⁰ In a 2000 case, *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765 (2000), the United States Supreme Court endorsed the "partial assignment" approach to *qui tam* relator standing to sue under the False Claims Act — allowing private individuals to sue on behalf of the U.S. government for injuries suffered solely by the government.

mechanism in Dodd-Frank and Affordable Care Acts. At present it seems that all three branches of the US Government agree on the utility and constitutionality of the *qui tam* as the most efficient model of the private enforcement, and the academic interest has shifted elsewhere.

The *qui tam* provisions of the False Claims Act implicate four constitutional doctrines: the Separation of powers doctrine (Articles I, II and III), the Standing doctrine (Article III), the Take Care Clause (Article II, Section 3), and the Appointments Clause (Article II, Section 2). As one scholar has pointed out, these disparate constitutional doctrines are "merely different doctrinal lenses through which commentators and courts look at the central problem with *qui tam*: someone other than the executive branch is litigating in the name of the United States"⁶⁶¹.

In *United States ex rel. Colucci v. Beth Israel Med. Ctr.*, 603 F. Supp. 2d 677 (S.D.N.Y. 2009) the Court found that False Claims Act actions survived death of relator because they were primarily remedial.

In 2009 the plaintiffs brought a constitutional challenge against the provisions of the FCA that require the complaint to be sealed for up to 60 days so the government can decide whether to intervene and allow the government to move the court for extensions. They argued the provisions violate the First Amendment by infringing on the public's right of access to judicial proceedings and the *qui tam* relators' right to speak about their complaint, and that mandatory sealing strips the courts' inherent ability to decide whether to seal on a case-by-case basis, thus violating the division of powers. In 2011 case, *American Civil Liberties Union v. Holder*, No. 09-2086 (4th Cir. March 28, 2011), the appeals court held that the sealing provisions addressed a compelling government interest of protecting the integrity of *qui tam* actions, and "do not violate the First Amendment or the separation of powers". The court further held the FCA provisions do not intrude on judicial self-administration.

In *United States ex rel. Drakeford v. Tuomey*, No. 13-2219 (4th Cir. July 2, 2015), the Fourth Circuit affirmed a FCA verdict against a hospital in South Carolina. The Tuomey case in over 10 years of litigation resulted in a \$237 million fine. The Court rejected Tuomey's arguments that an award so large constituted an unconstitutionally excessive fine. Earlier, in *United States v. Vill. of Island Park No. 90 CV992 (ILG)* (E.D.N.Y. Nov. 3, 2008) the Court determined that the Excessive Fines Clause did not apply because the False Claims Act was remedial. In *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 130 (2003) the Court ruled that treble damages "have a compensatory side, serving remedial purposes in addition to punitive objectives".

⁶⁶¹ Lovitt (1997), *supra* note 284 at 71, p. 859

The arguments of the academic camp that oppose *qui tam* are repetitive, and generally end up with an explicit or implicit conclusion that nobody else, but the executive branch is allowed to litigate in the name of the USA. Thus, Edgar (1991)⁶⁶² and Blanch (1993)⁶⁶³ give a paradigmatic argument that the False Claims Act *qui tam* provision violates Article III of the US Constitution by granting a cause of action to individuals who have suffered no “injury in fact” and thus lack constitutional standing. They both conclude that the *qui tam* provisions of the FCA are unconstitutional. Blanch also argues that the *qui tam* provision violates the Appointments Clause of Article II of the Constitution by allowing individuals who are not properly appointed officers of the US to litigate on behalf of the US. This leads him to the conclusion that the *qui tam* mechanism violates the separation of powers principle by stripping the executive branch of its responsibility to “take care that the Laws be faithfully executed”⁶⁶⁴. His verdict is that despite their long history, the FCA *qui tam* provisions are out of step with modern constitutional jurisprudence and should be held unconstitutional⁶⁶⁵.

Johnston (1994)⁶⁶⁶ adds up to the critique based on the separation of powers doctrine. He argues that the *qui tam* provisions of the FCA are unconstitutional to the extent that they vest prosecutorial discretion in executive-branch employees. This conclusion derives from the separation-of-powers doctrine and the underlying theory that the President is the unitary repository of the executive power. As Johnston argues, examination of case law and academic commentary demonstrates that the government's power of prosecution is constitutionally committed to the Executive, and that he or agents under his control must wield it in a unitary

⁶⁶² Edgar (1991), *supra* note 265 at 67

⁶⁶³ Blanch (1993), *supra* note 265 at 67

⁶⁶⁴ US Constitution, Article II, §3

⁶⁶⁵ Blanch, *supra* note 265 at 67

⁶⁶⁶ Johnston (1994), *supra* note 265 at 67

manner. Executive-branch employees are the agents of the government in collecting information on false claims, and the President must retain ultimate discretion over the use of prosecutorial power by any member of the executive branch. Accordingly, concludes Johnston, Congress's vesting of prosecutorial discretion in employees of the executive branch through statutory *qui tam* actions removes the President's constitutionally mandated control over prosecution and by doing so violates the separation of powers doctrine⁶⁶⁷.

Gausewitz Berner (2001)⁶⁶⁸ returns to the discussion about the collision between the standing doctrine and the *qui tam* practice after the Supreme Court's decision in *Vermont Agency of Natural Resources v. United States ex rel. Stevens*⁶⁶⁹ regarded as a notable victory for the proponents of *qui tam*. Through the analysis of the standing doctrine and what it implies about constitutional separation of powers the author criticises the *Stevens* decision for allowing a private uninjured plaintiff to bring suit for an injury suffered by the government, even if the government has concluded that the suit is without merit. "In allowing self-appointment by the whistle-blower ... the Court has tampered with the separation of powers and sidestepped the prosecutorial procedures of the Executive branch, which work to advance public policy rather than to achieve personal pecuniary gain."⁶⁷⁰ By allowing a private citizen to take a duty of the Executive branch and by accepting that private citizens may appoint themselves (although appointment is another responsibility reserved by the

⁶⁶⁷ *Ibid.*, pp. 626-630

⁶⁶⁸ Gausewitz Berner, N., Note, *The Uninjured Plaintiff: Constitutional Standing of Qui Tam Plaintiffs After Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 35 **University of San Francisco Law Review** 783 (2000-2001)

⁶⁶⁹ 529 U.S. 765 (2000)

⁶⁷⁰ Gausewitz Berner, *supra* note 654 at 143

Constitution to the Executive), the Legislative branch has transgressed the separation of powers concludes Gauzewitz Berner⁶⁷¹.

Some scholars engaged in a discussion on the difference between the citizen suit statutes and the *qui tam* legislation, building up an argument that contrary to the citizen suit a *qui tam* model is unconstitutional⁶⁷². As Feola (2003)⁶⁷³ argues, there are three fundamental differences between citizen suit statutes and the FCA. First, the citizen suit statutes provide the government with an unqualified right to intervene once a private citizen has commenced litigation. Second, these statutes allow citizens to sue on their "own behalf", and thus they have been assigned a private right, whereas the FCA only allows relators to sue in the name of the government. Then Feola builds up the following argument: FCA relators are not suing to redress a private injury, they are essentially acting as the government's agents, but suing in the name of the government is equivalent to enforcing a public right, and enforcing a public right is a core executive function⁶⁷⁴. Third difference between the citizen suit and *qui tam*, argues Feola, is that individuals enforcing citizen suits have no incentive to bring the suit other than to protect the health and welfare of similarly situated persons⁶⁷⁵. Unlike the FCA's bounty provisions, citizen suits do not explicitly provide damages to be awarded to the individual. Since the FCA does not contain the same type of safeguards to government involvement as citizen suits provide, concludes the author, the comparison is inappropriate.

⁶⁷¹ *Ibid.*

⁶⁷² Krent, H.J and Shenkman, E.G., *Of Citizen Suits and Citizen Sunstein*, 91 **Michigan Law Review** 1793, 1820-21 (1993), critique of Sunstein, C.R., *What's Standing After Lujan? Of Citizen Suits, "Injuries," and Article III*, 91 **Michigan Law Review** 163 (1992) and Sunstein, C.R., *Standing and the Privatization of Public Law*, 88 **Columbia Law Review** 1432 (1988)

⁶⁷³ Feola (2003), *supra* note 265 at 67

⁶⁷⁴ *Ibid.*, p. 166

⁶⁷⁵ *Ibid.*

The opposing camp of the defendants of *qui tam* in the US produced the robust defence of the constitutionality of *qui tam* legislation. Caminker in *The Constitutionality of Qui Tam Actions* (1989)⁶⁷⁶, addressing the doctrinal challenges in distinguishing between “the accepted” citizens' suit and “the suspect” *qui tam* suit, points out that the distinction between private and public interest representation is conceptually infirm⁶⁷⁷. The public is composed of individuals, so any injury to the “public at large” can be reconceptualised as an injury to each constituent member (“albeit one that is ubiquitous and perhaps intangible in nature”⁶⁷⁸). Referring to Sunstein⁶⁷⁹ Caminker notes that there exists no pre-legal, empirical sense in which a particular injury must be viewed as inherently “public” in nature⁶⁸⁰.

In Caminker’s view, the question of the *qui tam*’s constitutionality reflects a larger theme – whether the US Constitution empowers only the Executive branch to define and then secure through litigation the interests of the United States, or the constitutional system imposes upon the Branches a degree of overlapping responsibility, thus permitting the Congress to diffuse this power and authorise private citizens to represent the United States in Federal litigation⁶⁸¹.

Caminker concludes that the authorisation of *qui tam* actions remains a constitutionally acceptable means by which Congress may shape and secure the interests of the nation. The Congress' power to create new legal interests enforceable by private citizens in Federal court

⁶⁷⁶ Caminker (1989), *supra* note 184 at 44

⁶⁷⁷ *Ibid.*, p. 346

⁶⁷⁸ *Ibid.*

⁶⁷⁹ Sunstein (1988), *supra* note 658 at 144

⁶⁸⁰ Caminker, *supra* note 184 at 44, p. 346

⁶⁸¹ *Ibid.*, p. 348

is not bounded by a public/private distinction -- Congress may entitle private citizens through *qui tam* actions to enforce legal interests granted the United States on its behalf⁶⁸².

A little more than ten years later Bales in *A Constitutional Defense of Qui Tam* (2001)⁶⁸³ developed his argument along the line exploited by Caminker. The analysis suggests that there is a firm doctrinal justification for upholding the constitutionality of the FCA *qui tam* provisions, argues Bales. Because *qui tam* disperses power among the citizens rather than concentrating it in the hands of a single political branch, the principles underlying the separation of powers doctrine are not threatened as they are when, for example, Congress seeks to retain the power constitutionally apportioned to another branch⁶⁸⁴.

Some commentators, notes Bales, have argued that this is a bad idea to disperse that responsibility among the citizens because it decreases political accountability for actions taken in the name of the government⁶⁸⁵: the president must stand for election, whereas *qui tam* informers do not⁶⁸⁶. While this argument is not without merit, comments professor Bales, it overlooks the fact that political accountability is neither the only nor the most important value served by the separation of powers doctrine⁶⁸⁷. The primary purpose of the separation of powers doctrine was to preserve liberty⁶⁸⁸ by dispersing federal power among the three branches. "While this purpose may be subverted by the aggrandizement of or misallocation of power to one of the governmental branches, it is not seriously threatened by a dispersal

⁶⁸² *Ibid.*, pp. 387-388

⁶⁸³ Bales (2001), *supra* note 271 at 68

⁶⁸⁴ *Ibid.*, p. 436

⁶⁸⁵ Krent and Shenkman, *supra* note 658 at 144

⁶⁸⁶ Lovitt, *supra* note 284 at 71, pp. 874-875

⁶⁸⁷ Bales (2001), *supra* note 271 at 68

⁶⁸⁸ Susolik, E., Note, *Separation of Powers and Liberty: The Appointments Clause, Morrison v. Olson, and Rule of Law*, 63 **Southern California Law Review** 1515 (1990), pp. 1536, 1560-1564

of power among the citizens”, argues Bales⁶⁸⁹. In a *qui tam* action, the true party in interest is the citizenry -- the FCA empowers citizens to enforce the FCA directly, rather than indirectly through their executive branch representatives. This dispersal of power among the citizens, in Bales view, is not only consistent with, but affirmatively promotes, the purpose of the separation of powers doctrine⁶⁹⁰. The net effect, concludes author, is to weaken somewhat the power of the executive branch. If Congress were to attempt to privatise all federal law enforcement that certainly would be cause for constitutional concern, but transferring power from a branch of government to the citizens raises fewer constitutional concerns, and should receive less judicial scrutiny, than transfers of power from one branch to another, argues Bales⁶⁹¹. The *qui tam* action, therefore, should be analogised to citizen suit provisions, private suits, and corporate shareholder derivatives -- it disperses power instead of concentrating it, concludes professor Bales⁶⁹² with reference to Sunstein⁶⁹³. Viewed through this lens, particularly in light of the fact that the power transferred by *qui tam* is far from absolute, argues Bales, *qui tam* should definitely pass constitutional muster⁶⁹⁴.

Hartnett (1999)⁶⁹⁵ gives the discussion on the standing doctrine a new angle by arguing that the right of the government to bring criminal prosecutions depends not on any injury in fact to the government, but on the customary and statutory power of law enforcement officials to initiate criminal proceedings⁶⁹⁶. The attorneys general, both public and private, he

⁶⁸⁹ Bales (2001), *supra*

⁶⁹⁰ *Ibid.*

⁶⁹¹ *Ibid.*

⁶⁹² *Ibid.*, p. 437-438

⁶⁹³ Sunstein (1992), *supra* note 658 at 144

⁶⁹⁴ Bales (2001), *supra* note 271 at 68

⁶⁹⁵ Hartnett, E.A., *The Standing of the United States: How Criminal Prosecutions Show that Standing Doctrine is Looking for Answers in All the Wrong Places*, 97 **Michigan Law Review** 2239 (1999)

⁶⁹⁶ *Ibid.*, p. 2251

concludes, act on behalf of the public at large rather than to remedy an injury in fact to their own legally cognizable interests, and the statutory authorisation is sufficient to enable them to do so⁶⁹⁷.

The note by Averill (1999)⁶⁹⁸ is interesting by foreshowing the future trend in the development of the whistle-blower legislation. Averill proposes that the anti-retaliation provision of the False Claims Act should be expanded to protect from retaliation any individual who exposes fraud perpetrated on the United States government or who assists in a governmental investigation. He demonstrates that the hypothetical outcome resulting from the proposed amendment would have provided the whistle-blower a judicial remedy for the damages he suffered due to retaliation.

An earlier note by Park (1991)⁶⁹⁹ analyses the merits of the competing litigation and cause of action theories. It argues that adopting either as a bright line test would lead to perverse consequences in some cases. Park illustrates those effects by applying the theories to situations in which the application of procedural rules, *res judicata*, and constitutional doctrines turn on the governmental or private status of the plaintiff. The author concludes that the situational context in which the status issue arises best determines the theory, which should be applied.

⁶⁹⁷ *Ibid.*, p. 2258

⁶⁹⁸ Averill, J.W., NOTES, *Encouraging Individuals to Report Government Contracting Fraud: the Anti-Retaliation Provision of the Federal False Claims Act Should Protect Everyone Who Reports Or Helps Prosecute Fraudulent Conduct*, 77 **Washington University Law Quarterly** 901 (1999)

⁶⁹⁹ Park, V. R., Note, *The False Claims Act, Qui Tam Relators, and the Government: Which Is the Real Party to the Action?* 43 **Stanford law Review** 1061 (1991)

Bucy (2002)⁷⁰⁰ addresses constitutional issues raised by private justice, and predictably for her stance as a proponent of private justice argues that private justice complies with constitutional mandates. She concludes that the expansion of the FCA private justice model beyond the FCA's fraud-upon-the-government context is supported by constitutional history and theory⁷⁰¹.

Hamer (1997)⁷⁰² reviews the interim results of court hearings on the constitutionality of the *qui tam*. To date, Hamer notes, defendants have not succeeded in challenging the constitutionality of the *qui tam* provisions. The courts are understandably reluctant to find any basis for declaring the Act unconstitutional. He argues that although the theories used by courts to reject standing challenges have differed, the assignment theory seems to be the most appropriate basis for recognising relator standing. Further, Hamer points out, the *qui tam* provisions are consistent with the control theory enunciated by the Supreme Court in *Morrison v. Olson*⁷⁰³.

Ho (1999)⁷⁰⁴ describes the "real party in interest" doctrine and considers its role in courts' analysis of whether states may invoke their sovereign immunity to escape lawsuits based on the False Claims Act. He explains why a "real party in interest" analysis is incorrect in this context, and argues that courts should instead focus on the party possessing primary responsibility to prosecute an FCA action in determining whether a state can invoke immunity.

⁷⁰⁰ Bucy, P. H., *Private Justice and the Constitution*, 69 **Tennessee Law Review** 939 (2001-2002)

⁷⁰¹ *Ibid.*, p. 984

⁷⁰² Hamer (1997), *supra* note 271 at 68

⁷⁰³ 108 S. Ct. 2597 (1988)

⁷⁰⁴ Ho, J.Y., *State Sovereign Immunity and the False Claims Act: Respecting the Limitations Created by the Eleventh Amendment upon the Federal Courts*, 68 **Fordham Law Review** 189 (1999)

Morrison (2005)⁷⁰⁵ presents a work, which can be regarded as an example of academic vigilantism. He examines what he views as a new constitutional challenge to the private attorney general. The presumed challenge arises from *Nike v. Kasky*, a case ostensibly about the Supreme Court's commercial speech doctrine⁷⁰⁶. During proceedings in an amicus brief in support of Nike the Solicitor General of the United States urged the Court to adopt a special First Amendment limitation on private attorneys general⁷⁰⁷. Specifically, he argued that the First Amendment should prohibit private plaintiffs from enforcing speech regulations except to the extent they seek compensation for their own individual injuries⁷⁰⁸. At the same time, the Solicitor general maintained there should be no bar to direct government enforcement of identical regulations even in the absence of any showing of injury⁷⁰⁹. As Morrison summarises, the Solicitor General invited the Court to distinguish between publicly and privately enforced speech regulations, and to announce a rule generally preferring the former to the latter⁷¹⁰.

Morrison argues that a categorical First Amendment preference for public over private enforcement cannot be squared with existing free speech doctrine or the principles underlying it: to the contrary, as a general matter, the First Amendment properly regards private enforcement of speech-related laws as neither more nor less threatening to free expression than public enforcement⁷¹¹. However, Morrison goes further suggesting that the distinction between public and private enforcement urged in *Nike* is more than merely an

⁷⁰⁵ Morrison, T.W., *Private Attorneys General and the First Amendment*, 103 **Michigan Law Review** 589 (2004-2005)

⁷⁰⁶ *Nike, Inc. v. Kasky*, 539 US 654 - 2003

⁷⁰⁷ Brief for the United States as Amicus Curiae Supporting Petitioners, *Nike, Inc. v. Kasky*, 539 U.S. 654 (2003) (No. 02-575)

⁷⁰⁸ *Ibid.*, p. 8

⁷⁰⁹ *Ibid.*, pp. 14-20, 23

⁷¹⁰ Morrison (2005), *supra* note 691 at 150

⁷¹¹ *Ibid.*, pp. 646-669

unpersuasive First Amendment argument. Rather, he argues, it should be viewed against the backdrop of a number of efforts by the Supreme Court over the last decade to limit the power and influence of private attorneys general in a whole range of substantive areas, while leaving the government a relatively free hand to enforce the laws directly⁷¹². “To the extent this new public/private distinction seems attractive to the Court despite its doctrinal shortcomings, concludes Morrison, the reason may be that it seems to offer a novel means of advancing the Court’s policy-preferred end of elevating public over private enforcement. And that preference may, in turn, reflect a more fundamental hostility to regulation itself”⁷¹³.

Comment in the *Harvard Law Review* (2000)⁷¹⁴ and Nguyen (2005)⁷¹⁵ address the Eleventh Amendment defence in *qui tam* lawsuits. As authors note, over the past years, the circuits have considered whether the Eleventh Amendment bars suits against states by *qui tam* plaintiffs when the Department of Justice chooses not to intervene. In *United States ex rel. Stevens v. Vermont Agency of Natural Resources* the first four circuits to reach the issue⁷¹⁶ concluded that *qui tam* actions were effectively suits by the United States, and that the states’ sovereign immunity therefore did not apply. In *United States ex rel. Foulds v. Texas Tech University*⁷¹⁷, the Fifth Circuit broke ranks, and held that the Constitution bars *qui tam* actions

⁷¹² *Ibid.*, pp. 618-630

⁷¹³ *Ibid.*, p. 595

⁷¹⁴ Constitutional Law – State Sovereign Immunity – *Fifth Circuit Holds that Eleventh Amendment Bars Qui Tam Suits against States When the Department of Justice Does not Intervene* - *United States ex rel. Foulds v. Texas Tech University*, 171 F.3d 279 (5th Cir. 1999). 113 **HARVARD LAW REVIEW** 1057 (1999-2000);

⁷¹⁵ Nguyen, Hien Ngoc *Under Construction: Fairness, Waiver, and Hypothetical Eleventh Amendment Jurisdiction*, 93 **CALIFORNIA LAW REVIEW** 587 (2005)

⁷¹⁶ *United States ex rel. Stevens v. Vermont Agency of Natural Resources*, 162 F.3d 195, 202 (2d Cir. 1998), *cert. granted*, 11g S. Ct. 2391 (iggg);

United States ex rel. Rodgers v. Arkansas, 254 F.3d 865, 868 (8th Cir. 1998);

United States ex rel. Fine v. Chevron, U.S.A., Inc., 39 F.3d 957, 963 (9th Cir. 1994), *vacated on other grounds*, 72 F.3d 740 (9th Cir. 1995);

United States ex rel. Milam v. University of Tex. M.D. Anderson Cancer Ctr., 961 F.2d 46, 48 (4th Cir. 1992)

⁷¹⁷ 171 F.3d 279 (5th Cir. 1999)

against states when the Justice Department does not actively participate⁷¹⁸. In reaching its decision, the Fifth Circuit reasoned that the states' consent to be sued by the United States was conditioned on such suits being conducted by federal officers⁷¹⁹. As *Harvard Law Review* argues, this conclusion contradicts the early history of federal law enforcement, in which public prosecution played only a small role⁷²⁰: it would not have made sense for states at the Constitutional Convention to insist on public prosecution as a condition of waiving immunity given that the states would not necessarily have anticipated the creation of federal public prosecutors to conduct the government's suits⁷²¹. As authors conclude, the Fifth Circuit's rule disserves both the financial interests of the states and comity between state and federal governments⁷²², and "hypothetical Eleventh Amendment jurisdiction" should be renounced⁷²³.

Sturycz (2009)⁷²⁴ and Lumm (2010)⁷²⁵ take part in a scholarly discussion on *qui tam* with comments addressing the question whether *qui tam* provisions lead to hike in the volume of litigation and its economic cost. As Sturycz notes, in the instance where a False Claims Act *qui tam* claim is brought after a prior private claim was decided, close analysis of the relator-government relationship under the FCA indicates that the individual's suit under that statute ought not to be precluded. Since the interest held by a relator who sues under the FCA is distinct from any private interest that he may have previously litigated, the "identical parties"

⁷¹⁸ *Ibid.*, p. 281

⁷¹⁹ *Ibid.*

⁷²⁰ *Supra* note 700, p. 1062

⁷²¹ *Ibid.*, pp. 1059-1061

⁷²² *Ibid.*, p. 1062

⁷²³ Nguyen (2005), *supra* note 701 at 152

⁷²⁴ Sturycz, N.D, *The King and I?: An Examination of the Interest Qui Tam Relators Represent and the Implications for Future False Claims Act Litigation*, 28 **Saint Louis University Public Law Review** 459 (2008-2009)

⁷²⁵ Lumm (2010), *supra* note 265 at 67

element of claim preclusion cannot be met under current law, he argues. In theory, Sturycz admits, this revelation could open the floodgates of repetitious suits by individuals -- first under their private interests, and subsequently as FCA relators representing the government's interests. The FCA's text, however, allows the government discretion to prevent such repetitious litigation by giving the government sufficient control to temper any such efforts while also furthering Congress' stated goal of encouraging private individuals to expose and prosecute those who defraud the government, concludes Sturycz⁷²⁶.

Lumm examines the latest developments in the law of private whistle-blower enforcement under the provisions of the False Claims Act, and analyses the risks associated with broadening the scope of the FCA to expose an ever-increasing number of parties to potential liability under the Act. He concludes that the constantly broadening scope of potential liability under the *qui tam* provisions, and the multimillion-dollar rewards available by statute to the private parties bringing suit, will serve to increase the volume of litigation under the FCA. As a result, argues Lumm, operational and transactional costs will rise, primarily in the health care context, as new classes of potential defendants take measures to limit their liability exposure.

More arguments of the scholarly discussion on constitutional issues involving the *qui tam* provisions of the False Claims Act can be found also in Senagore (2007)⁷²⁷, Gilles (2001)⁷²⁸,

⁷²⁶ Sturycz, *supra* note 710

⁷²⁷ Senagore, A.J., "Based Upon" and the False Claims Act's Qui Tam Provision: Reevaluating the Seventh Circuit's Method of Statutory Interpretation, 3 **Seventh Circuit Review** 244 (2007) [online] Available at: <<http://www.kentlaw.edu/7cr/v3-1/senagore.pdf>>, (accessed on 30 August 2012)

⁷²⁸ Gilles, M.E., *Representational Standing: U.S. ex rel. Stevens and the Future of Public Law Litigation*, 89 **California Law Review** 315 (2001)

Shane (2000)⁷²⁹, Morgan and Popham (1998)⁷³⁰, Johnston (1994)⁷³¹, Robertson (1994)⁷³², Blanch (1993)⁷³³, Edgar (1990)⁷³⁴ and Lee (1990)⁷³⁵.

Academic literature on whistleblowing and whistle-blowers' protection

The academic literature on whistleblowing is vast, but patchy due to its conceptual incoherence. The term “whistleblowing” is too wide in its scope embracing different academic concepts from those supportive of private enforcement to those, which decry private justice. This part reviews the literature on whistle-blowing only when it falls into one of the two groups: the works analysing whistleblowing in general disregarding whether it is a key constituent element of a private enforcement mechanism or it is not; and the works which separate whistle-blowing as a civic activity from private justice, viewing it as a decent moral behavioural model opposite to the pecuniary motivated *qui tam* mechanism or irresponsible citizen suit.

Ebersole (2011)⁷³⁶ is characteristically typical in his critique of the expansion of the False Claims Act *qui tam* provisions, though he places his criticism within a broader sceptical view of whistleblowing. By expanding anti-retaliation protection and monetary incentives, Dodd-

⁷²⁹ Shane, P.M., *Returning Separation-of-Powers Analysis to Its Normative Roots: The Constitutionality of Qui Tam Actions and Other Private Suits to Enforce Civil Fines*, 30 **The Environmental Law Reporter** 11081 (2000)

⁷³⁰ Morgan and Popham (1998), *supra* note 165 at 67

⁷³¹ Johnston (1994), *supra* note 265 at 67

⁷³² Robertson, J.P., Comment, *The False Claims Act*, 26 **Arizona State Law Journal** 899 (1994)

⁷³³ Blanch (1993), *supra* note 265 at 67

⁷³⁴ Edgar, (1991), *supra* note 265 at 67

⁷³⁵ Lee, Th. R., Comment, *The Standing of Qui Tam Relators Under the False Claims Act*, 57 **University of Chicago Law Review** 543 (1990)

⁷³⁶ Ebersole, D., *Blowing the Whistle on the Dodd-Frank Whistleblower Provisions*, 6 **Entrepreneurial Business Law Journal** 123 (2011)

Frank enacts a new bounty programme, which very likely may be a misguided monetary incentive, argues Ebersole. In his view, Dodd-Frank's implications bring to light plausible alternatives to whistle-blower reporting for enforcing securities fraud, and highlight the importance of thoughtful business practices. Ebersole gives internal corporate procedures a priority over any form of a legislative initiatives encouraging whistleblowing. Notwithstanding any efforts to influence administrative rulemaking through public comment or legislative action through lobbying, he points out, businesses can and should promote compliance by taking steps: firstly, by preventing fraud and encouraging internal detection; secondly, by avoiding whistle-blower retaliation once fraud has been detected; and, thirdly, by complying specifically with the Foreign Corrupt Practices Act ("FCPA").

Ebersole's recommendations do not seem to be novel from the point made by Elliston *et al.* in 1985⁷³⁷. After stating that external fraud reporting can "embarrass the company by washing their dirty laundry in public"⁷³⁸, the authors recommend businesses to review their internal controls to prevent fraud and encourage internal reporting, if fraud does occur.

A number of academic works published within a span of twenty years after Elliston *et al.* prove that nothing much new has been born since by a corporate friendly, pro-internal control academic mind. Thus, Johnston (2003)⁷³⁹ insists that "employees uncovering fraud must balance a duty to society with organisational loyalty"⁷⁴⁰. Winfield (1994)⁷⁴¹ argues that proper internal controls and communication systems can serve as "a corporate safety net" against

⁷³⁷ Elliston, F. *et al.*, (1985). *Whistleblowing: Managing Dissent in the Workplace*. Praeger Publishers, New York

⁷³⁸ *Ibid.*, p. 135

⁷³⁹ Roberta Ann Johnston, (2003). *Whistleblowing: When it Works -- and Why*. Lynne Rienner Publishers

⁷⁴⁰ *Ibid.*, p. 27

⁷⁴¹ Marlene Winfield, *Whistleblowing as Corporate Safety Net*, in Vinten, G., (1994) *Whistleblowing: Subversion or Corporate Citizenship*. SAGE Publications Ltd

fraud, and render whistleblowing virtually unnecessary⁷⁴². While Cavico (2004)⁷⁴³ points out that employees are often reluctant to report fraud due to uncertainty regarding potential retaliation and condemnation by their peers, Dowling (2006)⁷⁴⁴ suggests that knowledge of prohibited activity and reporting procedures may encourage employees to report fraud internally. Miceli and Near (1984)⁷⁴⁵, point out that whistle-blowers may first report internally because they are not aware of incentives or options for external reporting⁷⁴⁶. However, as a research carried out by the National Whistle-blower Center in 2010⁷⁴⁷ shows, whistle-blowers usually report internally before reporting externally, even in the case of *qui tam* whistle-blowers, which are incentivised by a reward.

Some researchers point their criticism to the growing complexity of the burdensome legislation encouraging whistleblowing. Delikat and Phillips (2010)⁷⁴⁸ outline measures businesses can implement to comply with Sarbanes-Oxley Act, and point out that internal controls designed to avoid whistle-blower retaliation are getting more important with an increasing number of whistle-blowers likely to result from additional whistle-blower incentives. Morvillo and Robertson (2011)⁷⁴⁹ note that additional controls to prevent whistle-

⁷⁴² *Ibid.*, p. 25

⁷⁴³ Cavico, F., *Private Sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 **South Texas Law Review** 545 (2004)

⁷⁴⁴ Dowling, D. C., Jr., *International HR Best Practice Tips: Conducting Internal Employee Investigation Outside the U.S.*, 19 **International HR Journal** 1 (2006)

⁷⁴⁵ Miceli, M. P. and Near, J. P., *The Relationship among Beliefs, Organizational Position, and Whistle-Blowing Status: A Discriminant Analysis*, 27 **Academy of Management Journal** 687 (1984)

⁷⁴⁶ *Ibid.*, p. 224

⁷⁴⁷ *The Impact of Qui Tam Laws on Internal Compliance*, National Whistleblower Center 5 (2010), available at <http://sec.gov/comments/s7-33-10/s73310-212.pdf>

⁷⁴⁸ Delikat, M. and Phillips, R. (2010). *Corporate Whistleblowing in the Sarbanes Oxley/Dodd-Frank Era*. Practising Law Institute, 2d Ed.

⁷⁴⁹ Richard J. Morvillo and Jeffrey F. Robertson, *Whistleblowers and the Resurgence of Internal Investigations*, in BNA Corporate Accountability Report (11 January 2011)

blower retaliation and burdensome explanations to the SEC regarding the outcome of internal investigations “may be necessary due to the threat of increased whistle-blower reporting”⁷⁵⁰. They argue that new compliance burdens may be unnecessarily duplicative in light of other fraud detection measures already in place -- including external audits, internal audits and existing internal controls⁷⁵¹. Bowen *et al.* (2012)⁷⁵² point out that among additional costs which should be taken into consideration (and which routinely fall out of analyses) an SEC action following whistle-blower report may incur, there are such as a damage to the organisational reputation, decrease of the shareholder wealth, rise of monetary penalties, additional costs of corporate legal defence, and lost leniency for corporate self-reporting.

Wiener (2011)⁷⁵³ argues that protecting whistle-blowers reflects a careful balancing act. On the one hand, there is the desire to protect employees, to encourage disclosure, and to discourage corporations from engaging in fraud. On the other hand, he notes, compliance costs time and money. Significant increase in incentives bears risk of self-interested employees filing false reports in pursuit of bounties, or disgruntled ex-employees are seeking revenge on their old employers⁷⁵⁴. In his view, the piecemeal expansion of whistle-blower protections (a “statutory quagmire”⁷⁵⁵) only begets more piecemeal expansions, and a substantial overhaul of the underlying legislative rational becomes less likely. He advocates a movement towards “a comprehensive, unified, and properly incentivised system”, which

⁷⁵⁰ *Ibid.*, p. 30

⁷⁵¹ *Ibid.*

⁷⁵² Bowen, R. M., Call, A. C. and Rajgopal, Sh., *Whistle-Blowing: Target Firm Characteristics and Economic Consequences* (26 December 2009). AAA 2007 Financial Accounting & Reporting Section (FARS) Meeting Papers [online] Available at: <<http://ssrn.com/abstract=890750>>, (accessed on 7 January 2012)

⁷⁵³ Wiener, Ch., Notes, *Blowing the Whistle on Van Asdale: Analysis and Recommendations*, 62 **Hastings Law Journal** 531 (2010-2011)

⁷⁵⁴ *Ibid.*, p. 539

⁷⁵⁵ *Ibid.*, p. 552

would be invaluable in preventing future financial crises⁷⁵⁶. Lobel (2009)⁷⁵⁷ adds to this a noteworthy corporate inside: a deteriorating organisational culture has a cascading effect on internal compliance because employees are more likely to report fraud internally in organisations with an ethical culture, in which case there is less fear of retaliation⁷⁵⁸.

Macey in *Getting the Word about Fraud: a Theoretical Analysis of Whistleblowing and Insider Trading* (2007)⁷⁵⁹ offers a thought provoking unorthodox advance in the theory that both whistleblowing and insider trading are best analysed as involving rights in the same inchoate intellectual property: valuable information. Macey suggests that whistleblowing and one particular kind of insider trading – “insider trading on the basis of information about corporate corruption, corporate fraud or other illegal corporate conduct”⁷⁶⁰ -- are analytically and functionally indistinguishable as responses to corporate pathologies such as fraud and corruption. This, he argues, explains why whistle-blowers are sometimes viewed with suspicion and distrust, not only by their colleagues, but also by regulators and journalists⁷⁶¹.

Macey paints a complicated picture of a dubious merit to be a whistle-blower: “When giant businesses like Enron, Adelphia, or WorldCom are brought to their knees by whistle-blowers, innocent people are harmed. The innocent employees, small suppliers, local communities, and philanthropic organisations that depended on these firms suffer as much, if not more, than the firm's largely diversified investor base. These groups single out the whistle-blower

⁷⁵⁶ *Ibid.*

⁷⁵⁷ Lobel, O., *Lawyering Loyalties: Speech Rights and Duties Within Twenty-First-Century New Governance*, 77 **Fordham Law Review** 1245 (2009)

⁷⁵⁸ *Ibid.*, p. 1255

⁷⁵⁹ Macey, J., *Getting the Word about Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 **Michigan Law Review** 1899 (2006-2007)

⁷⁶⁰ *Ibid.*, p. 1900

⁷⁶¹ *Ibid.*, p. 1901

as the source of their trouble”⁷⁶². Moreover, adds Macey, revelations by whistle-blowers can be embarrassing to regulators, prosecutors, and others who are supposed to be on alert for fraudulent corporate activity.

Conversely, notes Macey, it also is the case that inside traders sometimes have fared surprisingly well in the courts -- in particular, in cases where insider trading leads to the same revelations about incipient fraud as whistleblowing would, courts can be remarkably accepting of such trading⁷⁶³.

In his article, professor Macey argues, that whether one has the right to blow the whistle on somebody else and whether one has the right to trade on the basis of non-public information ultimately depends on whether the persons engaging in the conduct have a rightful property interest in the information they are using⁷⁶⁴. If they do, concludes Macey, then the conduct, whether characterised as whistleblowing or insider trading, should be not only legally permissible, but affirmatively encouraged⁷⁶⁵. By contrast, in situations where the person doing the trading or the whistleblowing has no legitimate property interest in the information, the behaviour should be illegal.⁷⁶⁶

Austen-Smith and Feddersen (2008)⁷⁶⁷ and Depoorter and De Mot (2011)⁷⁶⁸ are interesting in their application of economic analysis to the analysis of the legal phenomena.

⁷⁶² *Ibid.*

⁷⁶³ *Ibid.*, p. 1908

⁷⁶⁴ *Ibid.*, pp. 1921-1926

⁷⁶⁵ *Ibid.*, pp. 1924-1925, 1927-1929

⁷⁶⁶ *Ibid.*, pp. 1929-1937

⁷⁶⁷ Austen-Smith, D., and Feddersen, T. J., *Public Disclosure, Private Revelation or Silence: Whistleblowing Incentives and Managerial Policy*, Northwestern University, December 2008

⁷⁶⁸ Depoorter. B., and De Mot, J., *Whistle Blowing*, Law and Economics Working Paper Series 04-56, George Mason University School of Law [online] Available at: <<http://law.bepress.com/gmulwps/gmule/art>> (accessed on 19 February 2011)

As Austen-Smith and Feddersen note, the highly secretive and premeditated nature of such crimes as corruption and fraud, prime witnesses are themselves often implicated in the fraudulent transaction. Promises of immunity and whistleblowing rewards are often required to resolve the information asymmetries. These insights have set a trend, the authors conclude, both in scholarship and law enforcement practice, towards reward-based approaches (carrots), as an alternative or complement to punishment based deterrence (sticks)⁷⁶⁹. Applying the False Claims Act as an analytical framework, the authors provide a critical review of the efficiency limitations of whistle blowing. The formal model developed in their work, reveals a gap between social and private incentives in whistleblowing, both with regard to the decision to pursue litigation and the timing of whistleblowing. First, while the insiders will blow the whistle whenever their expected recovery exceeds the expected costs of litigation, enforcement agencies seek to optimise enforcement in the long run. The autonomy of whistle-blowers to pursue claims without government involvement, weakens the government's bargaining position, and obstructs the government's ability to weigh in wider factors of enforcement, argue the authors⁷⁷⁰. Second, whenever rewards are tied to recovery, bounty awards create a perverse incentive whereby fraudulent practices are not terminated at a socially optimal point in time. The potential race among whistle-blowers cannot mitigate this effect fully because the stigma and loss of opportunities on the job market act as internal constraints on whistleblowing, the research concludes⁷⁷¹.

⁷⁶⁹ Austen-Smith and Feddersen, *supra* note 455 at 2

⁷⁷⁰ *Ibid.*, pp. 12-18

⁷⁷¹ *Ibid.*, pp. 23-26

Depoorter and De Mot start with a statement that whistleblowing is widely reported, economically significant and can be extremely costly to the whistle-blowers. In order to better understand the circumstances under which decision to blow the whistle is made, they develop a model of whistleblowing involving a manager and an employee. Each has a privately known type that specifies the relative weight placed on social rather than personal payoffs⁷⁷². The manager chooses a whistleblowing policy consisting of conditional penalties for various employee actions. The employee observes the policy and chooses between saying nothing, revealing a (privately observed) socially costly violation to the manager, or whistleblowing⁷⁷³. Given common knowledge of manager types the authors characterise equilibrium whistleblowing policies and employee behaviour. They show that there may be a nonmonotonic relationship between the severity of the violation and the likelihood of whistleblowing⁷⁷⁴. When manager types are private information the model provides sufficient conditions for a separating equilibrium. Managerial choice of whistleblowing policies thus proves to be a key element in a model, and serves a dual purpose: providing incentives for reporting violations and providing information to employees regarding the willingness of the manager to fix violations that are privately reported⁷⁷⁵.

An interesting contribution to the analysis of economic costs of whistleblowing for an individual was made by Maarten De Schepper (2009)⁷⁷⁶. Potential whistle-blowers would weigh the possibility of a reward against a number of opposing considerations: the likelihood

⁷⁷² Depoorter and De Mot, *supra* note 754 at 160, pp. 4-9

⁷⁷³ *Ibid.*, pp. 18-26

⁷⁷⁴ *Ibid.*, pp. 29-32

⁷⁷⁵ *Ibid.*, pp. 35-36

⁷⁷⁶ De Schepper, M., *Setting the Right Incentives for Whistleblowers*, 9 August 2009, Paper submitted for European Master in Law and Economics, [online] Available at: <www.emle.org/Marten_De_Schepper_-_Setting_the_Right_Incentives_for_Whistleblowers.pdf> (accessed on 21 October 2010)

of information they submitted actually being used, and whether the use would result in a successful legal proceeding; whether they would lose their own income; whether they would incur personal legal liability for their own part in the scheme; whether they would lose their anonymity; whether they would become a target of retaliation in the workplace and subject of alienation from colleagues. There is a threat that they are will be blacklisted by the peer companies and will lose not only the current income, but also any future income in the well-paid financial sector. The author presents a formula, which as he argues, provides a mathematical verification of the personal cost to step against the employer. The key message of this work is that whistle-blowing might well be classified as a form of occupational suicide; therefore high reward is required to solve the basic problem that it is too expensive to an employee to guard the law.

Among the most important recent publications stands the 2010 *Who Blows the Whistle on Corporate Fraud?* by Alexander Dyck, Adair Morse and Luigi Zingales⁷⁷⁷ from the Chicago School of Law and Economics. In attempt to identify the most effective mechanisms for detecting corporate fraud Dyck, Morse and Zingales conducted the most profound and complex study to date of all reported fraud cases in large American companies between 1996 and 2006. The key question they had asked themselves later made the title of their research paper -- "Who blows the whistle on corporate fraud?" The study has found that fraud detection does not rely on obvious actors (investors, SEC, auditors), but takes a village of several non-traditional players (employees and media) with surprisingly effective role of industry regulators⁷⁷⁸.

⁷⁷⁷ Dyck et al. (2010), *supra* note 13 at 10

⁷⁷⁸ *Ibid.*, p. 37

The carried out by the authors' analysis of whistle-blowers' incentives suggests that positive reputational and career incentives tend to be weak⁷⁷⁹. On the contrary, monetary incentives seem to work well, without the negative side effects often attributed to them. Moreover, as the study shows, monetary incentives for fraud revelation play a role regardless of the severity of the fraud. In particular, in healthcare (an industry where the government employs a bounty system for whistle-blowers through qui tam provision) 41 per cent of frauds are brought to light by employees. This contrasts with only 14 per cent of cases detected by employees in all other industries⁷⁸⁰.

The data provided by the study allows the authors to test the still dominant views on who should detect financial fraud. While, the legal view claims fraud detection belongs to auditors and securities regulators, the private litigation view attributes it to law firms. And the finance view argues that monitoring should be done by those with residual claims (equity and debt holders) or their agents (analysts and auditors)⁷⁸¹.

The study provides no support neither for the legal view, since the SEC accounts for only 7 per cent of the cases and auditors -- for 10 per cent, nor for the private litigation view (3 per cent of the cases)⁷⁸². Finance view also finds a weak support: debt holders were rare; equity holders play only a trivial role, having detected just 3 per cent of the cases⁷⁸³. Equity holders' agents (auditors and analysts) collectively account for 24 per cent of the cases analysed⁷⁸⁴. But the actors with no residual claims in the firms involved and therefore are traditionally

⁷⁷⁹ Except for journalists, but for this category the incentives exist only for very large frauds in famous companies. (*Ibid.*, p. 4)

⁷⁸⁰ *Ibid.*, p. 18

⁷⁸¹ *Ibid.*, pp. 27-32

⁷⁸² *Ibid.*

⁷⁸³ *Ibid.*

⁷⁸⁴ *Ibid.*, p. 33

considered as much less important players in the corporate governance arena, turned out to play a key role in fraud detection: employees (17 per cent of the cases), non-financial market regulators (13 per cent), and the media (24 per cent)⁷⁸⁵.

The same authors made a step further in their most recent research paper *How Pervasive is Corporate Fraud?* (2013)⁷⁸⁶. Using the dataset of frauds from the previous research⁷⁸⁷, Dyck, Morse and Zingales developed a comprehensive sample of frauds from Security Class Action cases. The frauds include those involving financial misrepresentations, but not limited to those. The sample relies on the fact that the security class action system provides strong incentives (for attorneys and shareholders) to file suit whenever a fraud that is likely to have a material impact is revealed⁷⁸⁸.

With the dataset the authors tackled the question of unobservable fraud by appealing to basic probability rules for guidance of going from observed data of the joint event of engaging in fraud and being caught, to the actual variable of interest, the probability of engaging in fraud regardless of whether the perpetrators are caught or not⁷⁸⁹. The identification strategy employed exploits circumstances in which the likelihood of being caught increases significantly. By comparing the differences in detection in this special circumstance, and in normal circumstances, the authors produced an estimate of the iceberg (i.e. the normal

⁷⁸⁵ *Ibid.*, p. 35

⁷⁸⁶ Dyck, I. J., Morse, A. and Zingales, L., *How Pervasive is Corporate Fraud?* (22 February 2013). Rotman School of Management Working Paper No. 2222608 [online]. Available at: <<http://ssrn.com/abstract=2222608>> or <<http://dx.doi.org/10.2139/ssrn.2222608>> (accessed on 29 September 2013)

⁷⁸⁷ Dyck *et al.* (2013), *supra*, p. 10

⁷⁸⁸ Dyck *et al.*, *supra* note 772, p. 3. For large companies, it is highly unlikely that detected frauds exist without a corresponding class action suit

⁷⁸⁹ *Ibid.*, pp. 5-7

detection likelihood), and then go a next step to estimate the unconditional pervasiveness of engaging in fraud⁷⁹⁰.

The authors take advantage of the natural experiment created by the demise of Arthur Andersen that forced all firms that previously had Andersen as their auditor to seek another auditor⁷⁹¹. The scandal enhanced the incentives of new auditors to be active. As a result, Dyck et al. have found that the incidence of fraud detection by auditors goes up by a multiple of close to four⁷⁹². This gives a sense of how much undetected fraud exists more generally, with the iceberg being 3 times bigger under the water than above the water. Thus the authors arrive at their best estimate that 14.5 per cent of large publicly traded corporations engage in fraud⁷⁹³, with a very conservative lower bound estimate close to 5.6 per cent⁷⁹⁴.

The next step of the research was to estimate the social costs of fraud. Dyck *et al.* construct a new measure of the cost of fraud, which they define to be equal to the difference between the enterprise value after the fraud is revealed and what the enterprise value of the company would have been in the absence of fraud⁷⁹⁵. Using this approach, the authors estimate that the median loss is 20.4 per cent of the enterprise value of the fraud companies (the firms' enterprise value prior to the beginning of fraud was set as the benchmark)⁷⁹⁶. Putting the estimate of the extent of fraud with the estimate of the cost per firm of fraud, the research produces an estimate of the social cost of fraud for these firms as a percentage of their

⁷⁹⁰ *Ibid.*, pp. 8-10

⁷⁹¹ *Ibid.*, pp. 10-11

⁷⁹² *Ibid.*, p. 12

⁷⁹³ *Ibid.*, p. 13

⁷⁹⁴ *Ibid.*, p. 15

⁷⁹⁵ The hypothetical value is constructed by making projections from the pre-fraud period, with assumption the trajectory would have followed that of other firms in the same industry (*Ibid.*, p. 25)

⁷⁹⁶ *Ibid.*, p. 26

enterprise value. The final price tag turns out to be 3 per cent of enterprise value of all large corporations⁷⁹⁷.

Though for Luigi Zingales *qui tam* and whistle-blower protection have never been in the centre of his scientific interests, his works such as *The Costs and Benefits of Financial Market Regulation* (2004)⁷⁹⁸ and *The Future of Security Regulation* (2009)⁷⁹⁹ regard whistle-blower incentives as a cost effective way to tackle corporate fraud.

A significant research into the effectiveness of whistle-blower rewards has been published by the Texas Tech University in 2010. Its author Derek Dalton applied Theory of Planned Behaviour (Ajzen, 1991) to the published in 1993 Schultz *et al.* model explaining whistle-blower intentions, and predicting whistle-blower behaviour. As a result a more comprehensive model has been developed, accounting for the perceived degree of difficulty to report wrongdoing (perceived behaviour control), and the potential benefits that may result from an individual's decision to report wrongdoing⁸⁰⁰.

Conclusions

⁷⁹⁷ *Ibid.*, p. 29

⁷⁹⁸ Zingales, L., *The Costs and Benefits of Financial Market Regulation* (April 2004). ECGI - Law Working Paper No. 21/2004 [online] Available at: <http://ssrn.com/abstract=536682> or <http://dx.doi.org/10.2139/ssrn.536682> (accessed on 30 April 2010)

⁷⁹⁹ Zingales (2009), *supra* note 12 at 10

⁸⁰⁰ Dalton, D. (2010). *A Two Essay Dissertation Examining Whistleblower Behavior* [online]. Available at: <http://www.researchgate.net/publication/265567767_A_Two_Essay_Dissertation_Examining_Whistleblower_Behavior> (accessed on 9 April 2011)

The accrued body of research on *qui tam* comprises a significant number of academic publications, mostly articles, which focus on relatively narrow aspects of this phenomenon, with majority directly or indirectly engaged in academic discussion on constitutionality of *qui tam* legislation. So far *qui tam* has survived all judicial challenges, and legislative branch shows no signal that it is ready to downscale it, or revise existing legislation to limit its scope, or somehow else reconfigure. Thus, from practical point of view, academic challenges to *qui tam* remain exercise in theoretical reasoning. Historical analysis of the *qui tam* legislation in America leaves no doubt that the framers of American Constitution were familiar with relevant statutes, which had been enacted by British colonies in North America long before the Revolution. Soon after framing the Constitution the same Congress enacted a number of *qui tam* statutes, giving by that fact a proof that the founding fathers of the United States viewed *qui tam* as a normal practice.

The review of the earlier scholarly publications on *qui tam* in England, carried out for the purposes of this research, has discovered that the views on *qui tam* set forth by Sir Edward Coke in late XVI – early XVII centuries had been widely misread, giving mistaken impression of him as a hardline critic of the practice common in his time. His often quoted “viperous vermin” derogatory description of some delators refers to what he viewed as their abuse of the otherwise noble practice. Lord Coke’s work was called upon to promote remedies to redress violations, and the popular in later literature derogatory term cannot be attributed to a much broader, in his view, group of law enforcement activists of the time.

Even in its entirety, academic literature on *qui tam* gives a patchy picture and does not favour a holistic approach. But a significant number of narrow focused works provide with deep analysis on the chosen topic, and the growing number of research turns to analysis and

interpretation of the meticulously collected data. As a general rule, however, predominant are the works, which are high in theory and low in statistically valid data. This leaves a broad niche for a further research in the field.

Of those research papers not dedicated to the constitutionality debates, a relative majority choose law and economics perspective as their methodological framework. Though most law and economics research of *qui tam* do it assuming it is a viable and socially valuable legal concept, division of opinion among American academics would rather follow a frontier separating more statist and less statist foundational assumptions – with more scepticism among the former, and more enthusiasm among the latter.

Summarising the rendered above literature review, it must be admitted that so far only a few researchers showed consistent interest in historical perspective in their works on *qui tam*. Absent are attempts to explore a broader context, in which this law enforcement mechanism has been evolving through the millennia, developing a high degree of sensitivity to political, economical and societal changes. The analysis carried out in the next chapter is the first attempt of the kind.

Chapter III

Law and Economics Analysis of *Qui Tam* Legal Concept

The conceptual framework of this research is based on the economic analysis of law (also known as Law and Economics)⁸⁰¹. Economic concepts are used to explain the effects of laws, to assess which legal rules are economically efficient, and to predict which legal rules will be promulgated.

Economic analysis of law can be characterised as the most advanced methodological tool for legal policymaking and structural analysis of existing and projected legal institutions, and concepts. Legal rules are scrutinised under aspects of allocation efficiency including transaction costs, the problems of externality and risk, distributional consequences and incentive compatibility.

Economic analysis of law derives from several different intellectual traditions in economics. Ronald Coase⁸⁰² and Guido Calabresi⁸⁰³ are generally identified as the first who applied the tools of microeconomic theory to the analysis of legal rules and institutions. Their seminal

⁸⁰¹ Some scholars make distinction between Law and Economics, and Economic analysis of Law [Miller, G.P., *Law and Economics versus Economic Analysis of Law* (April 7, 2011). NYU Law and Economics Research Paper No. 11-16, [online]. Available at SSRN: < <http://ssrn.com/abstract=1804920> > or <<http://dx.doi.org/10.2139/ssrn.1804920> > (accessed on 14 September 2013)]

⁸⁰² Coase, R.H., *The Problem of Social Cost*, 3 **Journal of Law and Economics**, 1 – 44 (1960)

⁸⁰³ Calabresi, Guido, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 **Yale Law Journal** 499–553 (1961)

articles were published respectively in 1960 and 1961. However Commons (1924)⁸⁰⁴ and Hale (1952)⁸⁰⁵ among others had brought economic thinking to the study of law in the 1910s and 1920s.

Another famous contributor to the theory was American economist Gary Becker⁸⁰⁶. Despite being credited as a first economic imperialist, actively promoting economic methods as a framework to analyse most of human activities, his frame of reference – rational choice theory of economics is understood to be rigorous, powerful and persuasive in analysing if not all, but at least a number of legal issues related to criminal justice.

Richard Posner in 1973⁸⁰⁷ brought about the debate around the philosophical foundations of economic analysis of law. He made two claims: (I) Common law legal rules are, in fact, efficient; and (II) Legal rules ought to be efficient. In both claims, “efficient” means maximisation of the social willingness-to-pay. In the course of the controversy, two more claims were later articulated by Kornhauser (1984, 1985)⁸⁰⁸: (III) Legal processes select for efficient rules; and (IV) individuals respond to legal rules economically. The former provoked

⁸⁰⁴ Commons, J. R., (1924). *Legal Foundations of Capitalism*, MacMillan, New York

⁸⁰⁵ Hale, R., (1952). *Freedom Through Law: Public Control of Private Governing Power*, Columbia University Press, New York

⁸⁰⁶ Becker, G.S. (2002). *The Economic Approach to Human Behaviour*. 6th edition; Becker, G.S. A Theory of Competition Among Pressure Groups for Political Influence, 98 **The Quarterly Journal of Economics** 371-400 (1983)

⁸⁰⁷ Posner, R. (2014). *Economic Analysis of Law*, 9th edition, Walters Kluwer Law & Business

⁸⁰⁸ Kornhauser, Lewis A., *The Great Image of Authority*, 36 **Stanford Law Review** 349–389 (1984); Kornhauser, Lewis A. and Lawrence G. Sager, *Unpacking the Court*, 96 **Yale Law Journal** 82–117 (1986)

a wide spread criticism⁸⁰⁹, but Kornhauser identified the last, behavioural claim, as the central one.

The typical model in economic analysis of law assumes that public officials conscientiously apply the legal rule under study. The public officials do not identify the rule that would best promote their own preferences, and then apply (or not apply) that rule. As the theory argues, they “conscientiously” apply the rule that “ought” to govern the event. If the effects of the legal rule are the central focus of some inquiry, the incentives and behaviour of public officials who enforce that rule may be of less interest⁸¹⁰.

In terms of law and economics the latest amendments to the *qui tam* legislation in the Financial Reform Act can be assessed as a triumph of a combination of normative economic analysis⁸¹¹ and legal positivism⁸¹², which appears to have become the dominant approach of the President Obama’s administration. While positive law and economics seeks explain the law, or the legal system, as it is, normative law and economics seeks to describe how the law or the legal system should be, providing by far the progressive camp of a political class with a strong reformist agenda. But the the government’s practitioners should tread carefully when applying these reforms, as Hylton, a normative jurist himself, pointed, “the normative law and economics approach ... reflects at bottom an arrogant belief in the power of theory to

⁸⁰⁹ Krecke, E. *The Nihilism of the Economic Analysis of Law*, Austrian Scholars Conference, 2001. Ludwig von Mises Institute

⁸¹⁰ *Ibid.*

⁸¹¹ Bentham, J., (1928). *A Comment on the Commentaries: A Criticism of William Blackstone’s Commentaries on the Laws of England*. Charles W. Everett ed., Oxford: Clarendon Press [online] Available at < <http://www.jstor.org/pss/1113015> > (accessed on 3 March 2011); Calabresi, G., (1970). *The Costs of Accidents: A Legal and Economic Analysis*. New Haven and London: Yale University Press

⁸¹² Holmes, O.W., (2009). *The Common Law*. Republication of the 1st original edition (1881). Chicago: American Bar Association; Posner (2014), *supra* note 793 at 169

provide useful policies for reforming complicated institutions”⁸¹³. From this point of view the US financial reform epitomises the upper hand of a Pigouvian approach over Coase⁸¹⁴, when the former seeks to improve the deeply flawed markets, as it sees them, by designing the perfect legislation. Being a strong advocate of a government intervention, British economist Pigou set a framework governing the current US work on regulation: an externality makes competitive market outcome inefficient, only a Government intervention can fix the problem⁸¹⁵.

However surprisingly it is, but at least one part of the legislation shows strong influence of the opposite legal concept, in due course of the Coasean argument that the market imperfections may derive from the flaws in regulatory environment, therefore there is no need to create a new legislation, but to amend the existing one -- the biggest gain can be probably obtained by eliminating the negative effects of pre-existing regulation⁸¹⁶. This approach is visible in those provisions of the Dodd-Frank Act, which refer to the incentives to encourage whistle-blowers, who report financial fraud⁸¹⁷.

The *qui tam* legislation clearly relates to the ideas of the Chicago School law and economics, which long argues that a reward system for corporate whistle-blowers can provide a very low cost alternative to external monitoring systems, while other forms of regulation have more dubious effect⁸¹⁸. It is worth mentioning that the relation to the Chicago School views does not necessarily mean adherence to the fundamentalist strong-form rationality assumption

⁸¹³ Hylton, K.N., (2003). *Antitrust Law: Economic Theory and Common Law Evolution*, Cambridge University Press, New York, p. 8

⁸¹⁴ Pigou (1938), *supra* note 11 at 10; Coase (1960), *supra* note 788 at 168

⁸¹⁵ Referring to Pigou’s theory of regulation, Coase allegedly lamented: “it is strange that a doctrine as faulty as that developed by Pigou should have been so influential”, (cited in Zingales (2004), *supra* note 784 at 167, p. 1)

⁸¹⁶ Zingales (2004), *supra* note 784 at 167, p. 11

⁸¹⁷ The abovementioned provisions are described in the following sections

⁸¹⁸ Zingales (2004), *supra*

that has become a defining characteristic of this school⁸¹⁹. This research adopts the framework, developed by Guido Calabresi, where a man stands weakly rational – rational, but subject to some pretty consistent deviations⁸²⁰.

As Luigi Zingales points out, contrary to popular misconception, Coase never subscribed to the extreme *laissez faire*⁸²¹. In his 1960 article he states “there is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency.”⁸²² Yet, Coase’s argument makes the case for regulation much more difficult to prove.

This research will revisit this debate with modern eyes. Consistent with Coase’s position, it will analyse the potential costs and benefits of the *qui tam* regulation. The most important costs of regulation are the resources spent to comply with it (Franks *et al.*, 1998)⁸²³ and the burden imposed to firms that should not have been regulated, but nevertheless, are subject to it (Hart, 2004)⁸²⁴.

Regulation improves outcome when enforcing contracts is very costly (Posner, 1998)⁸²⁵ or when limited liability restricts the ability to punish deviants (Shavell, 1984)⁸²⁶. Regulation has a role also when contracts are incomplete and renegotiation is hampered, as it is often the

⁸¹⁹ Becker (1968), *infra* note 830 at 178; Posner (2014), *supra* note 793 at 169

⁸²⁰ Calabresi (1970), *supra* note 803 at 170

⁸²¹ Zingales (2004), *supra*, p.15

⁸²² Cit. Zingales (2004), *supra*, p.11

⁸²³ Franks, J.R., S.M. Schaefer, M.D. Staunton, *The Direct Compliance Costs of Financial Regulations*, 21 **Journal of Banking & Finance** 1547-1572 (1998)

⁸²⁴ Hart, O., “The Wrong Way to Avoid a Corporate Scandal”, *Financial Times*, January 9, 2004

⁸²⁵ Posner, R. (1998). *Economics Analysis of the Law*, 5th edition, Boston: Little Brown

⁸²⁶ Shavell, S, *A Model of the Optimal Use of Liability and Safety Regulation*, 15 **Rand Journal of Economics** 271-280 (1984)

case in financial markets where one party to the contracts (the shareholders) is often too dispersed to be able to coordinate (an important point first raised by Zingales, 2004)⁸²⁷.

Some argue that economic analysis of law denounces any political intervention⁸²⁸. However, as Rajam and Zingales⁸²⁹ argued in their article, the starting point of their theory is that financial development is not a natural outcome of market forces, but requires political intervention. The Government needs to create the essential ingredients of developed markets, which includes respect for property rights, an accounting and disclosure system that promotes transparency, a legal system that enforces arm's length contracts cheaply, and a regulatory infrastructure that protects consumers, promotes competition, and controls egregious risk-taking.

The government has the ability to co-ordinate standards, and to enforce non-monetary punishments such as jail terms, that give it some advantage in regulating and policing. Some research showed evidence that government intervention was beneficial for financial systems. La Porta *et al.* (1997)⁸³⁰, for instance, show that laws protecting investors are an important determinant of financial development across countries. Similarly, in their study of the evolution of the Czech and Polish financial systems, Glaeser *et al.* (2003)⁸³¹ argue that the peremptory *laissez faire* attitude of the Czech government in 1990s deprived the market of the legal and regulatory infrastructure necessary for financial development.

⁸²⁷ Zingales (2004), *supra*, p.15

⁸²⁸ Krecke, E. *Nihilism of the Economic Analysis of Law*, Austrian Scholars Conference, Ludwig von Mises Institute 2001, [online]. Available at <<https://mises.org/journals/scholar/Krecke.PDF>>, (accessed 29 April 2014)

⁸²⁹ Rajam, R. and Zingales, L. (2001). *The Great Reversals: The Politics of Financial Development in the 20th Century*. University of Chicago Center for Research in Security Prices, Working paper №526

⁸³⁰ La Porta, Florencio, Lopez de Silanes, Andrei Shleifer, and Robert Vishny, *The Legal Determinants of External Finance*, **Journal of Finance** 52 (1997)

⁸³¹ Gleaser, E., and Shleifer, A. *The Rise of the Regulatory State*, **Journal of Economic Literature**, June, 2003

It is sensible for the purposes to develop a framework to analyse *qui tam* regulation, how law and economics evaluate consequences and externalities of the newly enacted regulation. As Arrow (1972) states⁸³², economic activity needs trust. Following Guiso *et al.* (2001)⁸³³, trust is described as the posterior beliefs about the integrity of the system. Such a belief comes in part from the observed data, but in part from people's prior beliefs. Generic trust towards other people can predict the trust towards the stock market and the investment in the stock market (Guiso *et al.* (2008))⁸³⁴. To the extent that government regulation on *qui tam* can affect this level of generalised trust, it can improve or degrade stock market participation.

One way a government can affect people's trust is through a rigorous enforcement of existing rules. Salient events tend to weight heavily in people's mind. Thus, while highly publicised individual cases of fraud can have a negative effect on trust, highly publicised cases of enforcement can have a positive effect. In a cross-section of countries, Aghion *et al.* (2008)⁸³⁵ show that higher mistrust leads to a higher demand for government intervention. But a similar relationship also exists in the time series. After every major crisis, the demand for government intervention increases. For example, after the 1929 crisis, there was a large demand for intervention. The same is true after the Enron and WorldCom scandals. And the same is true after financial crisis of 2007-2011. Lack of government activities is perceived as indifference, while some intervention can engender hope that the system will improve and

⁸³² Arrow, Kenneth J., (1965). *Social Choice and Individual Values*, New Haven: Yale University Press, 2nd edition

⁸³³ Guiso, L, P. Sapienza, and L. Zingales, (2001). *The Role of Social Capital in Financial Development*, NBER WP

⁸³⁴ Guiso, L, P. Sapienza, and L. Zingales, *Trusting the Stock Market*, 8 **Journal of Finance** 6 2557-2600 (2008)

⁸³⁵ Aghion Philippe, Tomm Algom, Pierre Cahuc, and Andrei Shleifer, 2008, *Regulation and Distrust*; Aghion, Philippe, John Van Reenan, Luigi Zingales, 2008, *Innovation and Institutional Investors*, University of Chicago Working Paper

so raise the level of trust. As Hochberg *et al.*, (2009)⁸³⁶ point out, though it is hard to prove causality, but the passage of Sarbanes Oxley was followed by an increase in the general trust towards the stock market.

It is worth mentioning that not so long ago a new body of research emerged in the context of the economic analysis of law that challenged some of its important assumptions.

Thus far, the economic literature maintained the standard assumption, that economic agents were rational and made choices that maximise their own welfare. However, a growing body of research has challenged this assumption. Madrian and Shea (2001)⁸³⁷, for instance, show that people are much more likely to participate in a retirement plan when the default rule is that they are enrolled rather than when the default rule is that they are not enrolled, even if they are free to switch. Given the life altering effect of this decision, it is hard to rationalise the effect of such a tiny shift in the cost of the decision. Using this evidence, Thaler and Sunstein (2003)⁸³⁸ argue in favour of a strategic choice of default options aimed at maximising social welfare. If these options are simply a default, which the parties involved can change at no cost; their strategy comes at no real cost to individual freedom. For this reason, they label it “libertarian paternalism”. As other research shows, even this very bland form of paternalism seems to impact final outcomes (Thaler and Bernartzi (2004)⁸³⁹).

⁸³⁶ Hochberg, Yale, Paola Sapienza, Annette Vissing-Jorgensen, *A Lobbying Approach to Evaluating the Sarbanes-Oxley Act of 2002*, 2 **Journal of Accounting Research** 47 519-583 (2009)

⁸³⁷ Madrian B. and Shea D., *The power of suggestion: inertia in 401(k) Participation and Savings Behavior*, 4 **Quarterly Journal of Economics** 116 1149-87 (2001)

⁸³⁸ Thaler, T. and Sunstein, C., *Libertarian Paternalism*, 93 **The American Economic Review** 2 175-179 (2003)

⁸³⁹ Thaler, T. and S. Bernartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 1 **Journal of Political Economy** 112 164-187 (2004)

These works support the previous research by Hersch Shefrin, who is regarded as one of the founders of the behavioural economic movement. He argues that behavioural economic theories emerged when advances made by psychologists came to the attention of economists, and it happened in his view in 1982 when Daniel Kahneman, Paul Slovic and Amos Tversky published their book, *Judgement Under Uncertainty: Heuristics and Biases*⁸⁴⁰.

From the point of view of *qui tam* analysis, it is remarkable how Shefrin identifies three main factors in behavioural economics: Heuristic driven bias; Frame dependence; and Inefficient markets⁸⁴¹.

The behavioural economic framework may be promising when applied to the analysis of the recent emphasis on material rewarding whistle-blowers, which amounted to a paradigm shift in regulatory approach to whistleblowing as a political, economic and legal phenomenon. As it is shown in the research, the US regulatory framework before 2010 focused mainly on the measures to protect whistle-blowers from retaliation whether in the form of tough or subtle harassment or by firing them. At the moment the regulatory policy seems to evaluating a further increase in scope of a bounty based approach to encouraging whistleblowing. The bounty system has the advantage of decentralising the problem of enforcement, which apart from tackling the inevitable bureaucratic inaptitude significantly reduces its costs. With respect to more traditional forms of monitoring and regulatory control such a system presumably has two advantages. First, it does not require setting up a costly structure.

⁸⁴⁰ Kahneman, D., Slovic, P. and Tversky, A., (1982). *Judgement Under Uncertainty: Heuristics and Biases*. Cambridge University Press, New York

⁸⁴¹ Shefrin, H, (2002). *Beyond Greed and Fear: Understanding Behavioural Finance and the Psychology of Investing*. Oxford University Press, New York

Second, by creating competition for enforcement, it reduces the chances that the potential enforcer is bought off. In more details this will be elaborated below in this chapter.

The main approach of the economic analysis of law -- to use standard microeconomic tools in order to explain the logic of jurisprudence as strive for efficiency – has long been criticised both from outside and within that school⁸⁴². Using sophisticated models, this school sought to show the mechanisms by which the law encourages economically efficient social behaviour. The law and economics theories operate, out of necessity, at a relatively high level of abstraction, applying elaborated mathematical models to derive precise quantitative predictions for overall normative assessments. However, such simplifying assumptions, as critics point out, seem to create a substantial risk of overlooking essential aspects of the analysed area of inquiry, and may generate predictions of little relevance to the actual circumstances⁸⁴³.

For the reason, “the social sciences have to deal with structures of essential complexity, whose characteristic properties can be exhibited only by models made up of relatively great numbers of variables,”⁸⁴⁴ such assumptions leave many important questions unanswered. As Morrison emphasised, mathematics, in excess, blurs our perception of economic and legal institutions⁸⁴⁵. Ronald Coase himself was sceptical about the rational choice theory -- one of

⁸⁴² Krecke (2001), *supra* note 824 at 175, p.3

⁸⁴³ Crespi, G. S. *Exploring the Complicationist Gambit: an Austrian Approach to the Economic Analysis of Law*, 73 **Notre-Dame Law Review** 2 (1998), p. 68

⁸⁴⁴ Machelski, T. *A Critique of Law & Economics – An Austrian School Perspective*. 31 **Studies in Logic, Grammar and Rhetoric** 44 2017-218 (2012), p. 211

⁸⁴⁵ Morrison, A.D., *Rating Agencies, Regulation and Financial Market Stability* [in:] Booth, P. (ed.) (2009), *Verdict on the Crash: Causes and Policy Implications*, The Institute of Economic Affairs, p. 120

the pillars of the economic analysis of law. In 1988 he said: “When economists find that they are unable to analyse what is happening in the real world, they invent an imaginary world which they are capable of handling”⁸⁴⁶.

Some economists within that school of thought long ago came to question the rationality assumption on which economic theory is built. Ulen (1999)⁸⁴⁷, for instance, criticises traditional rational choice theory for being unable to provide legal economists with a methodical account of the fallibility of human reason. He makes the success of future law and economics dependent on the development of a more complex and complete theory of human decision-making, which combines rational choice theory with coherent insights of human fallibility. Such a theory, in his view, would be vastly more satisfying than rational choice theory in order to serve as a foundation for the elaboration of legal systems, whose goal it is to create incentives for individuals to act efficiently⁸⁴⁸.

The same logic has led this research to employ more flexible methodological framework, than the original wave of law and economics suggested. It employs a more behavioral approach, taking into account some of the sociological and political aspects of a legal phenomenon. In this respect the applied frame of reference drifts away from a rigid cage of the Chicago-school “scientific” framework towards more Calabresian reading of the law and economics, the one that melds “political” concepts – like interpersonal comparison of utility and justice⁸⁴⁹ -- onto neoclassical economics. In search of the more efficient model of deterrence, the behavioral

⁸⁴⁶ Coase, R.H. *The Nature of The Firm - Meaning*, 4 **Journal of Law, Economics and Organization** 1 19-32 (1988), p.24

⁸⁴⁷ Ulen, T.S. “The Present and Future State of Law and Economics”, in Ott, C. and Schafer, B. (eds.) (1999). *New Developments in Law and Economics*, Erasmus Programme in Law and Economics, vol.2

⁸⁴⁸ *Ibid.*

⁸⁴⁹ Calabresi, G., (1970). *The Costs of Accidents: A Legal and Economic Analysis*, pp. 24-26

approach allows incorporating a Mertonian structural-functional idea of deviance and anomie⁸⁵⁰ in the analysis of white-collar crime.

The applied theoretical framework shares with the Austrian perspective the view of a society's legal system as closely related to the subjective preferences and the conduct of the individuals who constitute that society. The evolution of such a system is open-ended and unpredictable, though it is possible to identify prevailing trends and make predictions. It is a framework of the earlier Austrians though, namely Friedrich Hayek, who contrary to the popular view never completely rejected a rational choice theory – one of a pillars of law and economics. What he rejected was “rationalism” with its ignorance of the agents' perspective, which, in Hayek's view, could easily lead to the overestimation of rational planning and control, in terms of their abilities to effectively shape the societal development.⁸⁵¹ Hayekian vision is that it is not clear what the original purpose of the law was⁸⁵², because the law emerges as the result of “human action, not human design”⁸⁵³. Legal rules and institutions are determined as part of an on-going social learning and adaptation process which operates through trial and error, experimentation, imitation and compromise.

The sprawling pervasive nature of the *qui tam* legal mechanism, and its ability to change legal mandates through the decisions of courts, exploring and bringing forward innovation, perfectly fits into Austrian understanding of law and how the law applies. The pluralistic conceptual framework, which distance itself from elaborate mathematical modeling, allows

⁸⁵⁰ Merton, R. K., *Social Structure and Anomie*, 3 **American Sociological Review** 5 (October 1938) 672–682

⁸⁵¹ Hayek, Friedrich von, *Scientism and the Study of Society II*, **Economica**, 10: 34–63 (1943)

⁸⁵² Hayek talks about the «purposeless common law»

⁸⁵³ Hayek, F.A. (1960). *The Constitution of Liberty*, Routledge and Keagan Paul, London, p.35

the multi-layered analysis of this research to adopt for its purposes both behavioural economics and new governance theory without compromising on the premises of the rational choice theory and economic efficiency of law. As it was noted, legal theory today is much more of an amalgam of theoretical approaches⁸⁵⁴. An approach with direct relevance to a particular problem can be often irrelevant to other problems.

A *qui tam* mechanism is applied mainly to the problem of crimes conducted within big corporations, where agents represent a very specific social group with very calculative minds and often distorted work ethic, where financial success elevates to the ultimate reward, or “utility” in terms of economic analysis of law. In this area of public life law and economics provides a useful analytical framework, particularly when sufficiently flexible to employ the Merton’s theory of deviance.

The analysis proceeds as follows.

First, *qui tam* mechanism positioned within the context of public-private enforcement and then successively analysed by modelling effective regulatory enforcement policy and more robust deterrence built on broad-based inclusion of complex factors affecting behaviour of potential whistle-blowers. The model then has been tried to find an optimal cost-effective equilibrium of agency based and private based enforcement. The final part of the chapter is dedicated to the analysis of the first empirical evidence of the way the recent rise in whistleblowing activity affected the corporate world.

⁸⁵⁴ Hackney, J.R. Jr., *Law and Neoclassical Economics: Science, Politics, and the Reconfiguration of American Tort Law Theory*, 15 **Law and History Review** 275 (1997) 63

Analysing *Qui Tam* in the Context of Public vs. Private Enforcement

In an era of diminished public resources prompted by the severe economic crisis many bodies of US Government are being forced to take drastic measures to address stringent budgetary constraints. As budgets of law enforcement around the countries affected by the recent crisis have been either scaled back or strictly limited the enforcement capacities have been narrowed. One conceivable response is the outsourcing, including the prosecution function. In fact, “prosecution outsourcing currently is utilized in surprising measure by jurisdictions in the United States”⁸⁵⁵. Advocates of outsourcing cite efficiency, enhanced service, and cost savings as rationales for the private performance of these criminal justice functions.

This is not something new for the US regulatory system. As Glover notes, it “is unique in that it expressly relies on a diffuse set of regulators, including private parties, rather than on a centralised bureaucracy for the effectuation of its substantive aims”⁸⁵⁶. In contrast with traditional view of private enforcement as an *ad hoc* supplement to public law, some forms of that private regulation are integral to the structure of the contemporary American administrative state. The most important (and massive) is private litigation and the mechanisms that enable it are not merely add-ons to the US regulatory regime, much less are they fundamentally at odds with it. *Qui tam* is another historical model of private enforcement. The part below will try to offer some systemic view of *qui tam* as private (or

⁸⁵⁵ Fairfax, Jr., R. *Outsourcing Criminal Prosecution?: The Limits of Criminal Justice Privatization*. The University of Chicago Legal Forum 265-297 (2010), p. 265

⁸⁵⁶ Glover, J.M. *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 **William and Mary Law Review** 4 1137-1217 (2012), p. 1137

more precisely dual private/public) enforcement mechanism by providing elements of a conceptual framework for tailoring to the contours of particular regulatory regimes. This framework seeks a most effective way to align private enforcement mechanisms with the regulatory and public goals.

The debate over private versus public enforcement of laws is part of the economic analysis of law. It focuses mainly on one aspect of the optimal structure of law, namely, who should be the actor initiating and prosecuting the enforcement. Other aspects of an optimal legal system include⁸⁵⁷:

- Governing by the law or simply by social norms
- The optimal timing of legal intervention (before an act, after an act or after harm has occurred)
- The optimal form of legal intervention (prevention, imposition of fines, liability for harm, imprisonment).

The discussion of the enforcement issue in law and economics commenced with an argument by Becker and Stigler (1974)⁸⁵⁸ in favour of private enforcement of laws in areas typically reserved to public enforcement, such as criminal law and tax law. They detected “a major error of the theory of rules” in the assumption that “rules provide any guidance or incentive to their enforcement”, and asked, if “society does not pretend to be able to designate who the bakers should be – this is left to personal aptitudes and tastes. Why should enforcers of laws be chosen differently?”⁸⁵⁹

⁸⁵⁷ Shavell, S. (2004). *Foundations of Economic Analysis of Law*, Harvard University Press, pp. 571-592

⁸⁵⁸ Becker, G.S. and G.J. Stigler, *Law Enforcement, Malfeasance and Compensation of Enforcers*, 3 **Journal of Legal Studies** 1-18 (1974); see also Becker, G.S. Crime and Punishment: An Economic Approach, 76 **Journal of Political Economy** 169-217 (1968)

⁸⁵⁹ Becker and Stigler, *supra*, p.14

Becker and Stigler proposed a system under which “anyone could enforce statutes and receive as compensation a fine levied against convicted violators”⁸⁶⁰. If violators cannot pay the fine, the state would impose on them some non-monetary punishment and compensate those enforcing the law. If persons are acquitted of charges, they would be compensated by those who took them to court. Impoverished enforcers would be required to post a bond or some other kind of “malpractice” insurance.⁸⁶¹ The right to use violence when enforcing the law would be granted to some licensed firms⁸⁶².

According to the authors, such system would offer some significant advantages over public enforcement. With compensation set at the right level, the incentives to enforce the law would be as high as the incentives of prospective violators to break the law, thus solving one of the major problems of the traditional system of public enforcement.⁸⁶³ Also, at this level of compensation there would be no danger of collusion between the violator and the enforcer of the law against the public for the enforcers could not be corrupted.⁸⁶⁴ As a result competitive market for law enforcement would evolve: specialised firms would lower the overall enforcement costs of society, taking advantage of technological innovation if this promises to enhance the efficiency of law enforcement.⁸⁶⁵

Landes and Posner (1975)⁸⁶⁶ critically responded to Becker and Stigler advocating for private enforcement of laws. Focusing on the area of criminal law, they showed that a system of

⁸⁶⁰ *Ibid.*, p.14

⁸⁶¹ *Ibid.*, p.15

⁸⁶² *Ibid.*, p.16

⁸⁶³ *Ibid.*, p.13

⁸⁶⁴ *Ibid.*, p.14

⁸⁶⁵ *Ibid.*, pp.14-15

⁸⁶⁶ Landes, W.M., and Posner, R.A. *The Private Enforcement of Law*, 4 **Journal of Legal Studies** 1-46 (1975)

private enforcement would not be as efficient as a system of optimal public enforcement save by chance⁸⁶⁷. On the contrary, they argued, it would lead to over-enforcement⁸⁶⁸.

It is worth noting that from an economic standpoint, optimal law enforcement is not equal to maximum law enforcement. Rather, optimal law enforcement minimises the sum harm to society caused by perpetrators and total enforcement costs⁸⁶⁹.

Assuming that perpetrators will choose to violate the law when the expected benefits from breaking the law are higher than the expected costs, all the society must do to reduce violations is to raise the “price” of breaking the law beyond the expected benefits of breaking the law⁸⁷⁰. This “price” $P(f,p)$ is a function of the sanction f imposed on the violator (monetary or non-monetary) and the probability p of apprehension and conviction. Seen from the perspective of the perpetrator, the price can be raised by increasing a) the likelihood of apprehension, b) the severity of the sanction, c) both.

From the viewpoint of society, the calculation is slightly different. Assuming some fixed optimal price P^* is sufficient to deter violations, the rational legislator will choose the combination of f and p which minimises enforcement costs. Since the actual process of law enforcement is costly, this combination is likely to include a relatively high monetary sanction f and a relatively low probability of apprehension and conviction p ⁸⁷¹. However, regulators may not simply choose an infinitely high monetary sanction as f . The higher this sanction the

⁸⁶⁷ *Ibid.*, pp.3-15

⁸⁶⁸ *Ibid.*, p.15

⁸⁶⁹ Polinsky A.M. and Shavell, S. “Public Enforcement of Law,” in Polinsky, A.M. and Shavell, S., eds. (2007). *Handbook of Law and Economics*. North Holland, Amsterdam, pp. 403, 407

⁸⁷⁰ Becker (1968), *supra* note 830 at 178

⁸⁷¹ *Ibid.*, pp.183 *et seq.*

more people will only notionally be deterred by it as they will not be able to pay the fee. Therefore, as pointed out Friedman (1984)⁸⁷², the higher the monetary sanction the higher the need for some supplementary non-monetary sanction such as imprisonment, which by default is more costly for society than the monetary sanction.

However, a system of private enforcement of laws will not permit regulators to undertake such “high sanction/ low probability strategy”. The reason is that in a system of private enforcement regulators can only adjust one variable -- f -- to achieve optimal enforcement, but they cannot control p . If regulators raise f , private enforcers cannot distinguish whether this is due to an increase in the value of law enforcement relative to other activities, or an effort to lower p and save enforcement costs. Thus, private enforcers are likely to *increase* the resources devoted to law enforcement when in a system of optimal public enforcement those resources would be *reduced*.

Landes and Posner stressed that their analysis should not be taken as a case for preferring public over private enforcement because this would require a comparison between private and *actual*, not optimal public enforcement⁸⁷³. Although their analysis has been contested and refined by other scholars in subsequent works⁸⁷⁴, they generally agree that the choice between public and private enforcement means searching for a “second-best” solution,

⁸⁷² Friedman, D.D., *Efficient Institutions for the Private Enforcement of Law*, 13 *Journal of Legal Studies* 379-397 (1984), p.381

⁸⁷³ Landes and Posner (1975), *supra* note 838 at 179, p. 15

⁸⁷⁴ Polinsky, A.M. *Private versus Public Enforcement of Fines*, 9 *Journal of Legal Studies* 105-127 (1980); Friedman, *supra* note 844

requiring complex considerations of various criteria, including the factual context of regulation⁸⁷⁵.

Following Landes and Posner analysis a framework of criteria for a second-best solution can be built up with proposed by Lars Klohn focused on enforcement costs as a major factor to be considered when choosing between public and private enforcement⁸⁷⁶. The Landes-Posner over-enforcement theorem holds only if the probability of enforcement is sufficiently low. If the probability of enforcement is unity, there can hardly be any over-enforcement. Therefore, in the Landes-Posner model, private enforcement becomes more attractive as enforcement costs decrease, holding everything else constant⁸⁷⁷.

In a real world, both private and public enforcement have several specific costs attached to them, points Klohn⁸⁷⁸. Enforcement costs mainly consist of information costs necessary to detect whether, to what extent and by whom a law has been broken, and the costs of prosecuting and sanctioning the perpetrator. Public enforcement requires some centralised system of information gathering, whereas private enforcement relies on a “de-centralised” system, in which violations of the law will be detected by some individual who has an incentive to enforce the law. Both systems have advantages and disadvantages⁸⁷⁹.

⁸⁷⁵ Shavell, S. *The Optimal Structure of Law Enforcement*, 36 **Journal of Law and Economics** 255-287 (1993); Shavell, S. (2004). *Foundations of Economic Analysis of Law*. Belknap Press of Harvard University Press; Garoupa, N. *The Theory of Optimal Law Enforcement*, 11 **Journal of Economic Surveys** 267-295 (1997)

⁸⁷⁶ Klohn, L., *Private vs. Public Enforcement of Laws – a Law & Economics Perspective*, Presented at the conference “Compensation of Private Losses – The Evolution of Torts in the European Business Law” on 25 November 2010 in Münster, Germany

⁸⁷⁷ Landes and Posner (1975), *supra* note 838 at 179, pp. 31-32

⁸⁷⁸ *Ibid.*

⁸⁷⁹ *Ibid.*

As Polinsky showed⁸⁸⁰, a centralised public system is very costly in regard of the collection of information. On the other hand, such system can achieve economies of scale, as for example in the case of a central registry for criminal offenders. Though, as Klohn remarks, a system of central information gathering can suffer from specific diseconomies of scale due to multiple layers of decision-making and reviews within an administrative body⁸⁸¹.

To be sure, a monopolistic private enforcer might achieve any economies of scale achieved by a centralised system of public enforcement as well⁸⁸². However, given that a system of central information gathering is superior to a de-centralised system, it is highly doubtful whether society should entrust a private monopolist with this task. First, any centralised information collection system raises questions of data protection and accountability. Second, society runs the risk of becoming dependent on the monopolist, giving it an opportunity to overcharge for its service.

So it makes sense to assume that the aggregate of private individuals usually has an informational advantage over a central agency, simply because the agency lacks resources to gather all the information that the dispersed public can collect⁸⁸³. In some areas of law, private individuals seem to have a “natural” informational advantage. In contract law, the contracting parties are the first to know whether a breach of contract has occurred or is likely to occur in the future⁸⁸⁴. The same is true for many torts – car accidents, nuisance cases, and neighbour disputes. In criminal law, Klohn argues, there is no such informational advantage for private enforcers, or even a “natural” informational disadvantage⁸⁸⁵: most crimes are

⁸⁸⁰ Polinsky (1980), *supra* note 846 at 181, p.107

⁸⁸¹ Klohn (2010), *supra* note 848 at 182

⁸⁸² Polinsky (1980), *supra* note 846 at 181, p.107

⁸⁸³ Klohn (2010), *supra*

⁸⁸⁴ Shavell (2004), *supra* note 847 at 181

⁸⁸⁵ Klohn (2010), *supra*

committed by people who intend to hide their identity. Moreover, in these situations a centralised system of information gathering can achieve great economies of scale by setting up a database collecting data about repeat offenders⁸⁸⁶.

In a next step comes an analysis of **enforcement incentives**. It may be presumed that they are optimal when the incentives of the person enforcing the law are perfectly aligned with the socially desirable incentives to enforce the law -- when the marginal social benefits from enforcing the law are equal to marginal social enforcement costs. A misalignment of incentives can occur under both private and public enforcement.

The central incentive-problem with public enforcement of laws is that the enforcer's personal interest in enforcing the law is usually lower than society's interest⁸⁸⁷. Public service employees usually receive a fixed salary and do not gain directly from enforcing the law. This poses an "omnipresent threat of collusion between the violator of the law and the public enforcement agent"⁸⁸⁸. The former has an incentive to pay up to the expected fine (or the monetary equivalent of a non-monetary sanction) to evade punishment⁸⁸⁹. On the other hand, public servants can be overly eager to enforce the law. They might prosecute cases according to the public attention these cases promise to bring⁸⁹⁰. They might seek to maximise their budget as opposed to optimally enforce the law. And they might be "captured" - discriminate against political enemies and favouring political friends when enforcing the law⁸⁹¹. If there is the danger of capture, granting private enforcement rights discourages the

⁸⁸⁶ *Ibid.*

⁸⁸⁷ Becker and Stigler (1974), *supra* note 830 at 178

⁸⁸⁸ Klohn (2010), *supra* note 848 at 182, p. 9

⁸⁸⁹ *Ibid.*

⁸⁹⁰ Posner (2014), *supra* note 793 at 169, pp. 664 *et seq.*

⁸⁹¹ Bucy (2002), *supra* note 453 at 106

regulated industry to lobby for a cut in the agency's budget or to otherwise weaken the agency's enforcement ability. Granting private enforcement rights, however, does give the regulated industry an incentive to lobby for laxer regulation.

It is almost apparent, that private incentives to enforce the law seem to be optimal when private parties are the victims of the violation of the law. In this case, the probability of enforcement approaches unity, if the expected benefits from law enforcement exceed the expected costs⁸⁹². Those affected by the law violation often have a competitive advantage in weighing these costs and benefits, at least when the social interest in bringing suit is strongly correlated with the private interest of potential plaintiffs. However, even when private enforcers are the victims of a violation of the law, their enforcement incentives might not be socially optimal for a number of reasons.

First arise *the compensation* problems.

If the law makes use of only non-monetary sanctions such as imprisonment to deter wrongdoers, especially in cases when the expected damage from breaking the law is large, there will be under-enforcement by private enforcers because they will usually not be able to cover their enforcement costs⁸⁹³.

For successful enforcement three conditions seem to be necessary. First, the incentives of private enforcers might be set at the right level if the state provides them with some monetary compensation⁸⁹⁴. This compensation would have to be as high as the costs of

⁸⁹² *Ibid.*

⁸⁹³ Polinsky (1980), *supra* note 846 at 180; Shavell (1984), *supra* note 811 at 172; Shavell (1993), *supra* note 847 at 181

⁸⁹⁴ Landes and Posner (1975), *supra* note 838 at 179

punishment for the perpetrator, because otherwise there would arise the opportunity of collusion between the perpetrator and enforcer to the detriment of the public⁸⁹⁵. If the compensation to private enforcers were increased to this level, however, the danger of under-enforcement would be replaced with the problem of over-enforcement, because private enforcers would try to increase p when regulators actually want to reduce p to minimise the total social loss from crime⁸⁹⁶.

Second, setting compensation at the right level involves a valuation problem. Regulators would have to determine the money value of evading prison to the average perpetrator. While it is assumed that such value can be determined in economic models⁸⁹⁷, it is highly debatable whether such valuation is possible in the real world.

Third, the above-mentioned argument assumes that private parties will be driven to enforce the law only for monetary rewards. Therefore, the problem of under-enforcement might be mitigated, if the people are driven by some desire for fairness, as is the case in some areas of law such as environmental law⁸⁹⁸.

However, there is one more complication. When the violation of the law causes negative externalities without directly affecting any person who could be defined as a victim (“victimless crimes” such as drug trafficking or insider trading⁸⁹⁹), private parties may not have the right incentives to enforce the law. Since there is no compensation to be gained from the suit (or since such consideration would not be identical to social harm), profit-driven private

⁸⁹⁵ *Ibid.*

⁸⁹⁶ Landes and Posner (1975), *supra* note 838 at 179

⁸⁹⁷ As argue Becker and Stigler (1974), *supra* note 830 at 178

⁸⁹⁸ Klohn, *supra* note 848 at 182, p.10

⁸⁹⁹ *Ibid.*

enforcers would require some additional compensation to be collected from the perpetrator, such as punitive damages, or through subsidies by the public. To set enforcement incentives at the right level, especially to avoid over-enforcement, regulators would drive themselves in a quandary to constantly solve very complicated calculations such as measuring the external damage from drug use or the monetary value of a loss in faith in the integrity of capital markets.

Next come *collective action* problems.

In a system of competitive private enforcement⁹⁰⁰ a collective action problem arises when several private plaintiffs engage in a wasteful “race to the courts”⁹⁰¹. If the expected reward is high enough, numerous private individuals may have an incentive to invest in preparing a suit even though enforcement by a single party may suffice, thus duplicating enforcement costs. Co-ordination could remedy the problem, but might not be feasible due to individually rational strategic behaviour.

In other environment, under a system of profit-driven private enforcement⁹⁰² parties will find it worthwhile to file suits even on unreasonable grounds, if the suit has a positive expected net value. They might bring “strike suits”⁹⁰³ just for their nuisance value, which depends on many considerations apart from the legal grounds of the claim, such as the danger of bad publicity or the expected litigation costs. While this danger is present in public enforcement of laws as well, it does not seem as high because public law enforcers do not profit monetarily

⁹⁰⁰ When parties compete to enforce the law

⁹⁰¹ Landes and Posner (1975), *supra* note 838 at 179, pp. 32-34

⁹⁰² If the incentive to enforce the law is some monetary gain for the private parties

⁹⁰³ Klohn, *supra* note 848 at 182, p. 11

from their enforcement, have a limited budget, and are held politically accountable for their actions.

Agency problems also complicate the system of private incentives to enforce the law.

If private enforcement of laws involves an agency relationship, such as between plaintiffs and attorneys in a class action, there is the danger of perverse incentives for the agent. For example, the attorneys have an incentive to settle a lawsuit on terms unfavourable for the plaintiffs if the settlement involves generous attorney fees⁹⁰⁴.

Finally the complex issues of **the enforcement policy** must be analysed by clearly identifying advantages and disadvantages of private and public enforcement.

Some scholars -- Stewart and Sunstein (1982)⁹⁰⁵, Blomquist (1989)⁹⁰⁶, Bucy (2002)⁹⁰⁷, Klohn (2010)⁹⁰⁸ -- argue that in terms of cooperation and self-regulation private enforcement renders it almost impossible to cooperate with regulated industries and to incentivise regulated industries to adopt self-regulation. It is true that private litigation remedies the capture problem when an agency is inclined to collude with those regulated against society. However, if there are alternative means to cope with the capture problem, private enforcement may engender an overemphasis on coercion and deterrence at the expense of

⁹⁰⁴ Landes and Posner (1975), *supra* note 838 at 179, p. 38

⁹⁰⁵ Stewart and Sunstein (1982), *supra* note 590 at 130

⁹⁰⁶ Blomquist (1989), *supra* note 435 at 106

⁹⁰⁷ Bucy (2002), *supra* note 453 at 106

⁹⁰⁸ Klohn (2010), *supra* note 848 at 182

negotiation and cooperation⁹⁰⁹. Also, it discourages companies to seek a cooperative solution when violations have occurred⁹¹⁰.

Another disadvantage of private enforcement, as long assumed, is that it renders almost impossible to exercise discretion not to enforce the law when non-enforcement is beneficial to society⁹¹¹. This point assumes that laws are usually over inclusive. Taken literally, they cover cases, which the legislator would have chosen not to cover, if it had known the particular case in advance. The economic explanation for over inclusion is that it is very costly to tailor a rule exactly to the conduct intended to be forbidden. Such tailoring is left to ex-post adjudication of individual cases by the courts.

Private enforcers have no incentive to exercise discretion with regard to over inclusive laws. Profit-driven private enforcers will seize the opportunity to enforce the law any time a positive return on the investment of enforcement costs can be expected.⁹¹² In contrast, a public enforcement agency can choose not to enforce the law in cases in which the social costs of enforcing the law exceed its benefits. This happens every day, when “the police overlook minor infractions of the traffic code; building inspectors ignore violations of building-code provisions that, if enforced, would prevent the construction of new buildings in urban areas; air traffic controllers permit the airlines to violate excessively stringent safety regulations involving the spacing of aircraft landing and taking off from airports”⁹¹³. Such discretionary non-enforcement can reduce the social costs of over inclusion without a

⁹⁰⁹ Stewart and Sunstein (1982), *supra*

⁹¹⁰ Klohn (2010), *supra*

⁹¹¹ Kovacic (1998), *supra* note 580 at 128; Beck (2000), *supra* note 4 at 5; Klohn (2010), *supra*

⁹¹² Landes and Posner (1975), *supra* note 838 at 179, p. 38

⁹¹³ *Ibid.*

corresponding increase in under inclusion⁹¹⁴. Non-profit-driven private enforcers⁹¹⁵ may be motivated to engage in socially beneficial discretionary non-enforcement, too. However, this holds only, if such non-enforcement conforms to their moral or political convictions⁹¹⁶.

It is reasonable to object that under a classic separation of powers, tailoring over inclusive rules is left to the courts and not to the public agencies, but this is not an economic argument. From an economic standpoint, giving discretion to the court to tailor a rule ex post simply means that the power not to enforce overly inclusive law is shifted to another official body⁹¹⁷. Agencies may have some comparative advantages for such tailoring because they are more familiar with the regulated activity and can act faster. Moreover, agencies can act before, and not after, the fact, thus preventing certain cases from ever going to court⁹¹⁸.

Economic analysis of law does not provide an unequivocal and conclusive argument in favour of either private or public enforcement. Concluding it is necessary to consider the effects of both mechanisms on the legal process to summarise the advantages and disadvantages of each of them.

The case for private enforcement of laws assumes that private actors bring more suits to court than public agencies, giving the judiciary more opportunities to refine vague and general standards contained in the law. This can create a public good and might well be worth the litigation costs not internalised by the plaintiffs⁹¹⁹. This is a consideration that can be taken

⁹¹⁴ *Ibid.*, p.40

⁹¹⁵ When private parties enforce the law because of some non-monetary motive, such as fairness considerations, political or ethical convictions

⁹¹⁶ Landes and Posner (1975), *supra*, p. 40

⁹¹⁷ Klohn, *supra* note 848 at 182, p. 13

⁹¹⁸ Engstrom (2012), *supra* note 441 at 105

⁹¹⁹ Landes and Posner (1975), *supra* note 838 at 1879, p. 45

into account by public enforcement agencies when exercising discretion not to enforce a law. However, some scholars argue that private parties are more likely than agencies to develop novel legal theories, creative approaches to dispute settlement and new techniques of investigation and proof⁹²⁰. For example, the prevailing view is that the most important US antitrust law decisions by the Supreme Court were initiated by private litigation⁹²¹. Another advantage of a private enforcement is that it effectively addresses the agency problem engendered by an administrative drift of law enforcement or other government bodies.

These fears have long been cited as a defence of the *qui tam* ability to vest prosecutorial authority to individuals on behalf of the government. When the executive branch fails to investigate and prosecute as a result of too cozy relationships with the regulated sectors, trade associations or individual companies, the individual may pursue the case in court subject to dismissal by the court. From the judicial branch perspective, the real shift might be not to the relators, but to the courts that exercise ultimate authority.

The proponents of the private litigation as an antidote to the government's inaptitude place a great deal of faith in the judiciary as immune to agency capture. The assumption is that the judiciary is not subject to outside influence and enforcement constrains the way that agencies are. While this may be correct, the conclusion requires more theoretical and empirical grounding than has been so far provided⁹²². Such faith (under-theorised, but

⁹²⁰ Bucy (2002), *supra* note 686 at 149; Rapp, G.Ch. *The Wreckage of Recklessness*. Washington University Law Review, Vol. 86, 2008, [online]. Available at SSRN: < <http://ssrn.com/abstract=1105423> > (accessed on 30 July 2014), and (2012), *supra* note 518 at 116; Engstrom (2012), *supra* note 441 at 105; Kwok (2012), *supra* note 577 at 128

⁹²¹ Klohn, *supra*, p.14

⁹²² Posner, E. and Vermeule, A., *Inside or Outside the System? (Public Law & Legal Theory*, Working Paper No. 422, Mar. 2013). [Online] Available at: http://chicagounbound.uchicago.edu/public_law_and_legal_theory/395/ Assessed on 29 March 2016

consistent in academic literature) in courts as outside guardians of proper incentives is not unique to this case. Posner and Vermeule have noted that this faith — which they derive from the so-called inside-outside problem — pervades much of legal scholarship⁹²³. As Posner and Vermeule point out, it may very well be true that courts have more public-spirited and less selfish motives than other government actors, or that the institutional structure constrains their self-driven motives more, but that point should not be assumed without further foundational support⁹²⁴.

On the other hand, an “incompetent, overworked, or inexperienced private counsel, whose interest may diverge from the public interest, may be generating case precedent that restricts government regulators”⁹²⁵. Assuming that private enforcement entails costs not borne by private plaintiffs (especially litigation costs in a system of publicly subsidised courts), private plaintiffs have an incentive for excessive litigation⁹²⁶. This danger is especially notable, if private parties derive benefits from litigation, which, from a social perspective, do not justify additional enforcement costs. Under profit-driven private enforcement of laws, these benefits may include not only the monetary recovery from the suit, but also any benefits derived from harassing and damaging the reputation of private competitors and the like. Under the non-profit-driven private enforcement, such benefits might include “the notoriety and increased membership that a public interest group may gain from a large number of high-profile cases”⁹²⁷. While this danger exists in a system of public enforcement of laws as well, it does not seem as severe because public agencies have a limited budget and can be held

⁹²³ *Ibid.*, pp. 22-37

⁹²⁴ *Ibid.*, pp. 7–8

⁹²⁵ Klohn, *supra*, p. 14

⁹²⁶ *Ibid.*

⁹²⁷ *Ibid.*

accountable for excessive litigation. Finally, in a system of private litigation the risk of erroneous decisions may increase because courts must decide sometimes difficult issues without the benefit of another public body reviewing the case first.

It is also possible that if courts defer to government agencies, they could indirectly be captured by the industry. Government agencies or departments are captured by the industry, and when and where the court defers to the government, the court has thus been captured⁹²⁸.

Without a conclusive argument in favour of either private or public enforcement it is reasonable to make an assumption that the combined model of private-public enforcement is the optimal solution in pursuit of efficiency. In some areas, the most effective law enforcement may imply a division of labour: private enforcers dedicate their resources to detect and prosecute those types of violations where public enforcers lack resources, abilities to collect necessary information, or incentives. *Qui tam* presents an example of such cooperative model when it acts as a dual plaintiff mechanism, but at the same time it holds an alternative ability to pursue prosecution by a private enforcer in case a government agent is captured or shows inaptitude of whatever else reason. This ability to effectively curb a bureaucratic drift of law enforcement and those governmental departments, which engage private contractors or make procurement for the government, holds *qui tam* unique.

In the next sections a *qui tam* law enforcement model will be analysed from the law and economics perspective in its capacity as a tool that provides legislative and judicial branches

⁹²⁸ Posner and Vermuele, *supra* note 925, p. 1180

of the government with ability to overcome inaptitude of its executive, and optimise expenses related to law enforcement and deterrence.

Applying Coasean Framework to the Law Enforcement

The theory of the firm developed by Coase can prove that a federal scheme that delegates a law enforcement role to private actors, such as the *qui tam* action, allows Congress to intelligently structure federal law enforcement in a way that makes the best economic sense. Like the private firm, government can weigh the relative costs of different institutional arrangements and minimise those costs. When Congress does so, it is acting for another legitimate purpose. Such delegations help to optimise costs of enforcement, raise the crime detection rate, built up effective deterrence, and mitigate an administrative drift underlying inaptitude of law enforcement.

In his famous essay *The Nature of the Firm*⁹²⁹, Coase broaches a central question to microeconomics: Why do people form firms that allocate the resources of production through internal management decisions instead of market transactions?⁹³⁰ A firm that needs cleaning services can set an example. The firm can fulfil this need in many ways, but three options illustrate the point. Option One lies at one extreme: the firm could make a new contract for

⁹²⁹ Coase, R.H., *The Nature of the Firm*, 4 *Economica* 16 386–405 (1937), [online]. Available at: < <http://onlinelibrary.wiley.com/doi/10.1111/j.1468-0335.1937.tb00002.x/epdf> > (accessed on 9 February 2010)

⁹³⁰ Coase defines a firm as follows: "The distinguishing mark of the firm is the supersession of the price mechanism... Within a firm... market transactions are eliminated, and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production" *Ibid.*, [online]

each and every cleaning task. If managers need to have its premises to get cleaned, they would enter the relevant market and negotiate a cleaning contract. Under this option, the market allocates the firm's cleaning work among different cleaners.

Option Two lies at the other extreme: instead of contracting out each cleaning assignment, the firm hires the cleaners as employees.⁹³¹ Under this option, the firm obtains help through a single market transaction -- hiring the cleaners -- and the firm's administrators allocate the resources.

Option Three presents a combination of the first two: the firm contracts with an agency for periodic cleaning services. The agency's fee will vary depending upon the firm's history of the cleaners' engagement. Under this option, both the market and the firm administrators allocate resources.

The three options illustrate how either the market or firm administrators may allocate resources to varying degrees. Through that Coase sought to explain why a firm would opt for one method of allocation over another. He offered a straightforward answer: "The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism."⁹³² Negotiating and concluding a market transaction is costly. Coase identified several types of transaction costs: the cost "of discovering what the relevant prices are";⁹³³ "It]he costs of negotiating and concluding a separate contract for each exchange

⁹³¹ In this case, the firm substitutes a single set of contracts -- hiring the cleaners -- for many more contracts over time. As Coase has explained, "contracts are not eliminated when there is a firm, but they are greatly reduced." *Ibid.* [online]

⁹³² Coase (1937), *supra* note 897 at 193 [online]

⁹³³ Coase writes that "this cost may be reduced but it will not be eliminated by the emergence of specialists who will sell this information", *Ibid.* [online]

transaction which takes place on a market";⁹³⁴ and the inability to make long-term contracts that will reduce the risk of periodic market fluctuations.⁹³⁵ Thus, in some cases, it might be cheaper for a firm to perform a task in house than to repeatedly engage in market transactions.

While comparing Option One to Option Two the firm will pursue the following logic. Under Option One, the firm would have to contact, negotiate with, and contract with a cleaner every time it wanted to have its premises cleaned up. The multiple market transactions would waste valuable managers' time, which would be spent securing cleaner's help instead of providing profit-generating services.⁹³⁶ Under Option Two, the firm must either divert managers' time to administrating and allocating cleaners' work or hire another manager to perform that function. The question then becomes whether the manager's time lost to contracting in Option One is greater than the cost of administering cleaners in Option Two. The question for the firm, then, becomes whether the cost of hiring cleaners as employees is less than the cost of contracting with a cleaning agency.

Firms perform the same cost comparison in deciding whether to organise other tasks in house or through market transactions. A rational firm's choice will rest on the relative cost of each option, which includes the transaction costs of each choice. According to Coase, this cost comparison dictates the structure and size of a firm.

⁹³⁴ Ibid. [online]

⁹³⁵ Ibid. [online]

⁹³⁶ This is the economic idea of "opportunity cost": the cost of any activity is not only the money spent on engaging in that activity, but also the opportunities foregone by engaging in the activity. See Posner (2014), *supra* note 793 at 169, p. 66

The next logical step is to assume that the government does act like the firm described by Ronald Coase. This assumption may bear the risk of criticism that it is irrelevant to compare the firm to the state, when the latter can never be forced out of business and bankrupted, like the former, due to the unique money printing authority. Consequently, a government would be indifferent to Coasean transaction costs, being able to expand its own costs infinitely at parity to the cost of printing. For this reason, Keynesian economic models exclude probability of government shut down as a result of unbearable debt⁹³⁷, and political scientists deny the prospect of government bankruptcy due to its power as a sovereign⁹³⁸.

This is a serious argument, which merits discussion prior to further development of the analysis.

The term bankruptcy in the sense it is widely used in respect of the government refers primarily to a limited legal procedure following bankruptcy under which the assets of the bankrupt can be formally seized to satisfy the claims of creditors. Indeed, it is impossible to imagine the seizure of US government assets upon request of its offended creditors. However, there are various ways, in which the sovereign may repudiate on its obligations without framing it as default, considerate euphemisms have been contrived to describe such forms of sovereign bankruptcy: from inflation, financial repression, currency debasement, to forcible conversions, lowering coupon rates, and unilateral reduction of principal⁹³⁹. According to Reinhart and Rogoff (2008), in over 200 years since 1800 there were about 250

⁹³⁷ Reinhart and Rogoff (2008), *infra* note 908 at 196; Tomz and Wright (2007), *infra* note 924 at 196; Levy-Yeyati and Panizza (2011), Ghosh *et al.* (2013), De Paoli *et al.* (2009), Acharya *et al.* (2014), Baldacci *et al.* (2011), Debortoli and Nunes (2010), Ostry *et al.* (2015), *infra* note 924 at 198

⁹³⁸ See, Krugman, P. and Wells, R.H., (2012). *Economics*. Worth Publishers

⁹³⁹ Reinhart, C.M. and Rogoff, K.S. *The Forgotten History of Domestic Debt*, NBER Working Paper No. 13946, April 2008 [online], available at: < <http://www.nber.org/papers/w13946.pdf> > (accessed on 15 September 2015), pp. 9-12

sovereign defaults in the world⁹⁴⁰, a number that correlates with the estimates of Tomz and Wright (2007)⁹⁴¹, who identified 250 defaults in 106 countries defaulted since the end of the Napoleonic Wars. Among those governments the majority defaulted more than once -- the most common defaulters were Ecuador, Costa Rica, Mexico, Uruguay and Venezuela, each of which experienced at least 8 distinct spells of default⁹⁴². Beers and Nadeau (2015) recently presented even higher estimates of sovereign defaults – between 1975 and 2014 141 countries repudiated their debt, most of them did it at least twice⁹⁴³. The United States did not escape that fate: American government defaulted four times in its history – in 1779, 1782, 1862, 1934 and, most surprisingly, in 1979⁹⁴⁴. Only a small group of countries (UK included) honoured their debt obligations impeccably⁹⁴⁵. However, in 1946 UK secured a long-term \$3,75 bln loan on favourable terms from the USA, plus another \$1.19 was provided by Canada⁹⁴⁶. The loans amounted to over 30 per cent of the total UK GDP for that year⁹⁴⁷, and effectively saved financial system of the country from imminent default⁹⁴⁸.

⁹⁴⁰ *Ibid.*, p. 10

⁹⁴¹ Tomz, M. and Wright, M. *Do Countries Default in “Bad Times”?* Federal Reserve Bank of San Francisco, Working paper 2017-17, 2007 [online], available at: <<http://www.frbsf.org/publications/economics/papers/2006/wp07-17bk.pdf>> (accessed 14 September 2015), p.3

⁹⁴² *Ibid.*

⁹⁴³ Beers, D. and Nadeau, J-S. “Database of Sovereign Defaults, 2015”. Technical report No 101, Bank of Canada [online]. Available at: < <http://www.bankofcanada.ca/wp-content/uploads/2014/02/tr101.pdf> > (accessed on 15 September 2015)

⁹⁴⁴ Chamberlain, J.S. *A Short History of US Credit Defaults*, Ludwig von Mises Institute, 2012 [online], available at: < <https://mises.org/library/short-history-us-credit-defaults> > (accessed on 15 September 2015)

⁹⁴⁵ Reinhart and Rogoff (2008), *supra* note 908 at 196, p. 20

⁹⁴⁶ Grant Jr. and Philip A. *President Harry S. Truman and the British Loan Act of 1946*, **Presidential Studies Quarterly**, (1995) 25 No3, pp 489–496

⁹⁴⁷ Sefton, J and Weale, M (1995). *Reconciliation of National Income and Expenditure: Balanced Estimates of National Income for the United Kingdom, 1920-1990*. Cambridge University Press

⁹⁴⁸ *Ibid.*

When a country maintains control over its monetary system, and due to its size and resources remains self-sufficient, it may stay afloat even being a serial defaulter, like Argentina or Venezuela. A smaller country with limited resources and restricted ability to monetise its debt can become insolvent, and end up under a sort of receivership, like Greece under effective financial control of the Troika after 2010⁹⁴⁹. In fact, Greece remotely resembles an insolvent company dependent on the debt financing, which filed for a bankruptcy protection under Chapter 11 of US Bankruptcy Code to survive as a going concern⁹⁵⁰. If governments keep full control over their printing press they may attempt to inflate away the debt, but as history shows quite often at their own peril. Hanke and Krus (2012) identified 56 well-documented episodes of hyperinflation in the world, which all with a sole exception of a revolutionary France had occurred in XX and XXI centuries⁹⁵¹. And not always governments may go away with it. Hyperinflations lead to financial collapses, which inevitably end up with ousting the incumbent governments through revolutions, civil wars, military coups or early parliamentary elections⁹⁵². Which in business parlance means being forced out of business. In extreme

⁹⁴⁹ J.Sfakianakis, "The Greek Depression". *The Foreign Policy*, [online], available at: < <http://foreignpolicy.com/2013/01/09/the-greek-depression/> > (accessed on 15 September 2015)

⁹⁵⁰ U.S. Code Title 11 [online], available at: < <http://www.gpo.gov/fdsys/browse/collectionUScode.action?collectionCode=USCODE> > (accessed on 15 September 2015)

⁹⁵¹ Steve H. Hanke, S.H. and Krus, N. *World Hyperinflations*. CATO Working Paper, 15 August 2012 [online], available at: < <http://object.cato.org/sites/cato.org/files/pubs/pdf/workingpaper-8.pdf> > (accessed on 15 September 2015). The research followed the definition of hyperinflation, developed by Cagan (1956), as a monthly price level increase of at least 50 per cent. See: Cagan, P. "The monetary dynamics of hyperinflation", in Friedman, M., (ed.) (1956). *Studies in the Quantity Theory of Money*, Chicago: University of Chicago Press; and Cagan, P. "Hyperinflation", in Eatwell, J., Milgate, M., and Newman, P. (eds.) (1987). *The New Palgrave: A Dictionary of Economics*, 2 (3), Macmillan Press Limited, London, pp. 704-706

⁹⁵² *Ibid.*, The Table

cases, the whole countries may consequently disintegrate (Somalia since early 1990s)⁹⁵³, and even disappear in perpetuity (USSR, Yugoslavia)⁹⁵⁴.

The above-mentioned examples lead to the conclusion that even a full control over its monetary policy and unrestricted access to the printing press cannot save the governments (and sometimes states) from financial and political collapse. It stands to reason that latest Keynesian macroeconomic models include such elements as debt sustainability level⁹⁵⁵ – even addressing a financial system of the US, the true “indispensable nation”⁹⁵⁶.

On the other hand, an insolvent company even after default on some or even all its debt, and repudiation of contractual payments may stay in business, and even avoid filing for bankruptcy. The latest financial crisis of 2007-2008 and subsequent recession of 2008-2012 enriched business history with such cases⁹⁵⁷.

⁹⁵³ Barrington, L., (2006). *After Independence: Making and Protecting the Nation in Postcolonial and Postcommunist States*, University of Michigan Press; Shillington, K., (2005). *Encyclopedia of African history*, CRC Press

⁹⁵⁴ Silber, L. and Little, A., (1997). *Yugoslavia: Death of a Nation*, Penguin Books; Finlan, A., (2004). *The Collapse of Yugoslavia 1991-1999*. Osprey Publishing

⁹⁵⁵ See: Levy-Yeyati, E., and Panizza, U. *The Elusive Costs of Sovereign Defaults*. 1 **Journal of Development Economics** 94 95–105 (2011); Ghosh, A., Kim, J., Mendoza, E., Ostry, J. and Qureshi, M. *Fiscal Fatigue, Fiscal Space, and Debt Sustainability in Advanced Economies*. **The Economic Journal** 123 (566) F4–F30 (2013); De Paoli, B., Hoggarth, G. and Saporta, V. *Output Costs of Sovereign Crises: Some Empirical Estimates*. Bank of England Working Paper 362, Bank of England, London (2009); Acharya, V., I. Drechsler, and Schnabl, P. *A Pyrrhic Victory? Bank Bailouts and Sovereign Credit Risk*. 6 **Journal of Finance** 69 2689–739, (2014); Baldacci, E., I. Petrova, N., Belhocine, G. Dobrescu, and Mazraani, S. 2011. *Assessing Fiscal Space*, IMF Working Paper 11/100, International Monetary Fund, Washington, (2011); Debortoli, D., and Nunes, R. *Fiscal Policy Under Loose Commitment*. 3 **Journal of Economic Theory** 145 1005–32, (2010); Ostry, J., Ghosh, A. and Espinoza, R. *When Should Public Debt Be Reduced?* International Monetary Fund, June 2015 [online] available at: < <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1510.pdf> > (accessed on 14 September 2015)

⁹⁵⁶ Madeleine Albright, US Secretary of State. NBC's *Today Show* (19 February 1998) [online], available at: < http://fas.org/news/iraq/1998/02/19/98021907_tpo.html > (accessed on 15 September 2015)

⁹⁵⁷ Kindleberger, Ch. P. and Aliber, R. Z., (2005). *Manias, Panics, and Crashes: A History of Financial Crises*, 5th ed., John Wiley & Sons, Inc.; *Financial Institutions: A State-Dependent Sensitivity Value-at-Risk (SDSVaR) Approach*, Working Paper, EBS; Adrian, T., and Shin, H. S., *Liquidity and Leverage*, 19 **Journal of Financial Intermediation** 3 (2010) 418 – 437; Brunnermeier, M. K., and Morgan, J., *Clock Games: Theory and Experiments*, 68 **Games and Economic Behavior** 2 (2010) 532–550; Duffie, D. (2012). “Systemic Risk Exposures: A 10-by-10-by-10 Approach,” in *Risk Topography: Systemic Risk and Macro Modelling*, ed. by Brunnermeier, M. K., and Krishnamurthy A., University of Chicago Press; Englund, P. *The Swedish Banking Crisis: Roots and Consequences*,

To sum up, the assumption that Coasean analysis of firm can be applied to governments is justified, and there are more similarities between governments and companies than meet the eye. Every theory rests on a set of assumptions to select the core of the phenomena from their periphery, and as Milton Friedman put his methodological principle, the robustness of a theory should be tested not by the realism of its assumptions, but by the accuracy of its predictions⁹⁵⁸. From this perspective, the Coasean conceptual framework – with all its limitations – has proved its relevance.

So, assume that the central government sometimes decides to perform one task in house and contract out another task based on the relative costs of those choices. Like a Coasean firm, government is an association of individuals formed to pursue certain goals. One of these numerous goals is enforcing various regulatory schemes. Assuming that the government has already made its decision on what regulatory scheme should exist; its officials then got a charge of its enactment.

If the government acts like a Coasean firm, it will decide based on the relative costs of the options, including transaction costs. To make efficient decisions the government might consider a number of factors. First of all, how in-house enforcement affects its staff needs. Any regulatory scheme must address the twin goals of detecting and deterring violations. In deciding whether to observe the law, as economic analysis of law assumes⁹⁵⁹, the rational

15 **Oxford Review of Economic Policy** 3 (1999) 80–97; Gennaioli, N., Martin, A., and Rossi, S. (2011). *Sovereign Default, Domestic Banks and Financial Institutions*, Working paper, CREI; Schularick, M., and Taylor, A. M., *Credit Booms Gone Bust: Monetary Policy, Leverage Cycles, and Financial Crises, 1870-2008*. 102 **American Economic Review** 2 (2012) 1029–1061

⁹⁵⁸ Friedman, M. “The Methodology of Positive Economics”, in Friedman, M. (1953). *Essays in Positive Economics*, University of Chicago Press, p.3

⁹⁵⁹ Posner (2014), *supra* note 793 at 169, p. 242 (“In order to design a set of optimal criminal sanctions, we need a model of the criminal’s behavior. The model can be very simple: A person commits a crime because the expected benefits of the crime to him exceed the expected costs.”). The rational potential perpetrator will also

member of society will weigh the expected cost of cheating (the probability of getting caught times the penalty/cost of getting caught) against the expected benefit of cheating (the probability of not getting caught times the amount of material gain). Consequently, one way to deter violations is to raise the probability of detection, or to lower the probability of non-detection through imposing strict liability for acts detrimental to the well being of the general populace⁹⁶⁰. To do so, the government could increase the number of checks, audits, personnel, and boost other efforts aiming at raising the likelihood of detection. If enforcement is performed in house, the government must hire enough professionals to perform the needed actions.

In addition to the quantity of enforcement actions the government might consider also significant qualitative changes. To adequately enforce the laws the government must conduct enforcement in a manner likely to detect violations. Otherwise, its actions will not increase the risk of detection and thus will not deter violations. Consequently the law enforcement becomes more rigorous, time consuming and engaging more employees (and more well-paid ones among them). As a result, labour will be one cost of in-house enforcement.⁹⁶¹ Labour itself has many cost components, wages and benefits being the most obvious. For example, recruiting and hiring employees costs money, as does monitoring and evaluating employee performance. If the government has enough employees, it might need an entire department

weigh the cost of strategies for avoiding detection or punishment, such as bribery and intimidation. See Becker and Stigler (1974), *supra* note 830 at 178

⁹⁶⁰ Becker, G.S. *Crime and Punishment: An Economic Approach*, in Becker, G.S., and Landes, W.M., eds., (1974). *Essays in the Economics of Crime and Punishment*, pp.1-14: "If the aim simply were deterrence, the probability of conviction ... could be raised close to 1, and punishments... could be made to exceed the gain: in this way the number of offenses ... could be reduced almost at will." Another way is to increase the penalty for the violation. As Professor Becker argues, however, increases in probability of detection and punishment have other effects on society that must be accounted for in modeling criminal law enforcement. *Ibid.*, pp. 14-18

⁹⁶¹ For factors affecting the efficacy of law enforcement, see Becker and Stigler (1974), *supra* note 830 at 178, pp. 2-5

devoted to employment matters. In fact, the government will face some of the same labour costs as a private company⁹⁶².

In-house enforcement will also impose travel and monitoring costs. The government must either pay for travel to investigate violations in remote places, or maintain regional field offices that police those locations. Either option carries costs. For the traveling employee, the government bears travel and lodging costs, as well as the cost of policing employee reimbursements to prevent fraud. For the field office, the government bears the cost of acquiring and maintaining the remote facility, as well as monitoring the work of employees at the remote site.

Second, in case of white-collar crime the government might consider contracts with accounting firms to conduct audits, and law firms to bring enforcement actions⁹⁶³. The government could either hire these firms on an on-going basis, for a specified period of time, or on a case-by-case basis. Or employ another solution – to delegate these functions to private citizens through the *qui tam* action. Each option has transaction costs -- the out-of-pocket expenses and opportunity cost of identifying, negotiating, and contracting with the

⁹⁶² The government also faces some costs not faced by private firms and does not face some costs faced by private firms. On the former, the government must not violate the Constitution when dealing with employees. For example, the government must accord its employees procedural due process before disciplining or terminating them. (*Mathews v. Eldridge*, 424 U.S. 319, 332 (1976)). However, the government may exempt itself from some laws that it imposes on private employers. For example, governments enjoy sovereign immunity from civil liability. See Federal Tort Claims Act, 28 U.S.C. § 2674 (1994) (defining the scope of the United States's tort liability)

⁹⁶³ For the first fifty years under the Constitution, the United States Government relied on private lawyers to prosecute federal crimes. See Conner, R., *et al.*, *The Office of U.S. Attorney and Public Safety: A Brief History Prepared for the "Changing Role of U.S. Attorneys' Offices in Public Safety" Symposium*, 28 **The Capital University Law Review** 753 (2000); Waxman, S.P., *Twins at Birth: Civil Rights and the Role of the Solicitor General*, 75 **Indiana Law Journal** 1297 (2000)

private firms. Also, the government would face agency costs -- the costs of monitoring the private firms so that they do not make wasteful or fraudulent charges to the government.

Third, the government might consider some mix of in-house and outside enforcement efforts. It could hire private accounting firms to conduct audits and leave enforcement actions to government lawyers. Employing the government lawyers would bring the costs associated with in-house enforcement, while contracting with the private accounting firm would pose the transaction and agency costs of outside enforcement.

The precise combination of in-house and outside contracting the Coasean government will select upon calculating the costs each option brings. The optimal mix of in-house and outside enforcement will depend on the costs associated with various enforcement contexts. Following Coasean framework, the sum of these costs will ultimately determine the size of the law enforcement bodies of the government.

The analysis rendered above shows that Coasean framework proves a robust tool in modelling government's approach to cost optimisation in general, and to optimisation of the costs related to law enforcement. The choice the government faces is similar to the choice made by any firm – do some function in house, to outsource, or to mix in-house and outside contractors to pursue some task. In real life a decision about optimal design of law enforcement has to be made within some particular context, and is influenced by political, economical and societal environment, but an underlying logic of the decision will remain the same – cost optimisation through public, private or mixed public-private model. In the next sections this logic will be applied to more complicated context dependent real life modelling of the role *qui tam* can play in law enforcement.

Modelling a *Qui Tam* Mechanism within Regulatory Enforcement Policy

In a wake of a severe economic crisis the law enforcement faces a number of challenges the predominant traditional model of enforcement proved insufficient to effectively address:

- The stringent budget limitations on providing financing even to the most important areas of law enforcement
- The significantly increased government involvement in corporate sector as a result of:
 - bail-outs of banks and rise in government backing of loss making businesses deemed to be too systemically important to go bust
 - dramatic rise in government involvement in health industry following the enactment of the Patient Protection and Affordable Care Act⁹⁶⁴
- The strong public request to tackle financial and -- broader -- corporate white-collar crime, particularly related to government procurement
- The objective limitations to employ the sufficient number of highly-skilled professionals to effectively conduct investigations of sophisticated corporate fraud
- Limited ability of the government led prosecution to obtain sensitive information crucial to success in delicate investigations of highly complicated corporate cases
- The administrative capture as part of a broader government agency problem resulting from growing interconnectedness between administration and ever-rising number of state contractors.

⁹⁶⁴ Public Law 111-148 March, 23 2010

As the analysis below proves the *qui tam* model of enforcement can effectively address all these challenges in a flexible way combining the advantages of both private and public justice while mitigating their respective weaknesses. Private enforcers may not always have a big picture view of law enforcement, but their collective efforts may allow public enforcers to better utilise limited resources. Having efficient tackling of government fraud as an example, the *qui tam* mechanism provides inside into the optimal design of a coordinated enforcement regime. The coordination of public and private enforcement efforts makes particular sense in the area of financial crimes within a complex economy. Following the concern regarding relative enforcement costs from Polinsky (1980)⁹⁶⁵, detection alone of such crimes may be the most difficult and costly step of the enforcement process.

Without sensitive information, a government law enforcement agency concerned about deterrence has a very difficult problem in determining the sufficiency of its enforcement efforts. Prompt detection by public authorities may require intrusive and costly monitoring techniques that could generate hostility, and have already provoked a political backlash with massive lobbying campaigns. In contrast, existing employees within such businesses and organisations have regular, real-time access to the information about potential legal violations. From the government perspective, personal detection by such employees is nearly costless, although for them to reveal this personal knowledge and pursue enforcement action is a very different story.

The cost/benefit analysis of a *qui tam* model within a broader analysis of deterrent efficiency provides guidance in search of the most cost effective enforcement mechanism. Following

⁹⁶⁵ Polinsky (1980), *supra* note 846 at 181

the Becker model of crime⁹⁶⁶, in which the potential fraudsters are contractors, providing some services or goods, with the federal government compensates them financially, there may be various motivations leading a contractor to commit fraud. Nonetheless, as an ostensibly profit maximising entity considering an economic crime, the Becker's model has relevance to the contractor's decision process. Building up on the Becker's work Kwok (2009)⁹⁶⁷ developed a model comprising *qui tam* relators.

In his model, the contractors are distinguished only on the size of the government contract they hold. Thus, the cumulative distribution of contracts is determined exogenously. One can interpret the distribution to be some technical distribution of contracts that leads to the optimum provision of services. The amount of contracts is understood as the opportunity for fraud given the contractual relationship with the government. For example, if some contractors are doctors filing for Medicare reimbursement, they may be filing numerous claims on behalf of a number of different patients. Since the opportunity for fraud extends across the various claims, their contracts' amount would be the sum of the limits of Medicare reimbursement for those patients.

Each contractor, having been allocated a particular contract amount, then chooses the amount of fraud to commit. The maximum amount of fraud a contractor can commit represents a situation in which it claims to perform all services or provide all goods but actually does nothing besides collecting federal money. If the contractor opts to properly fulfil the contract according to its terms, it loses profit. It is assumed a competitive situation such that performance of the contract, either in part or in whole, results in no profit to the

⁹⁶⁶ Becker and Stigler (1974), *supra* note 830 at 178

⁹⁶⁷ Kwok (2010), *supra* note 576 at 127 [online]

contractor. Thus, the contractor's only opportunity for profit lies in committing fraud. Although some researchers might view fraud as simply a transfer rather than a net loss for society, in his model Kwok assumes that the net loss to society is at least as large as the amount of fraud.

The risk neutral contractors, facing their decision on the amount of fraud to commit, are concerned about the probability of detection and punishment. If their fraud is discovered and punished, they will lose the amount of fraud times a damage multiplier. For the False Claims Act, treble damages and penalties is the only loss they suffer. There is no reputational loss, nor loss associated with the overall value of the contract. It is assumed that the contractor is not judgment proof, thus the penalty is meaningful.

The probability of detection and punishment of a contractor is a function of a contract fraud. The probability is an abstraction of the entire detection and judicial process. The model emphasises the role of the relators in stepping forward with their knowledge of the fraud. It is assumed that the relators' decisions are based upon the amount of fraud and that their chance of success in relating does not depend on the amount of fraud. The relator's action is always honest, accurately revealing fraud. Thus, if relators reveal their knowledge of the fraud, they will face some future professional and social stigma as whistle-blowers, which do not depend upon the amount of fraud. The relators receive benefits corresponding to the amount of the fraud: both in terms of the bounty percentage paid after successful litigation and the psychological benefits of helping to stop large levels of fraud. Thus, as the level of fraud increases, the relators are more likely to act. Notably, the contractors have no ability to

hide or fight the relators' actions; their only method of decreasing the detection and penalty is to drop the amount of fraud.

The model shows that when a contractor chooses fraud as a way to gain profit, relator relates successfully with given probability of success, which causes a contractor to lose profit. Then the contractor, knowing the probability of exposure, has a decision rule to maximise expected net profit in choosing more fraud with an unavoidable subsequent exposure by the relator. The model shows that private enforcement through the *qui tam* relators tends to deter high levels of fraud while leaving low levels of fraud untouched, thus, avoiding excessive litigation⁹⁶⁸. However, the downside is that under conditions when government resources are limited a significant number of modest in scope or marginal fraudulent actions will remain without countering. This points out to a flaw in law enforcement, which fails to deter crime below a given level, if the government is not added to the model. As it was pointed out above, prosecutorial discretion enhances efficiency of spending under limited budgets.

Analysing the role of the government, and its response aiming at increasing enforcement efficiency under pressure of limited resources, Kwok considers four possible objective functions for its regulator⁹⁶⁹. The fraud itself is viewed as a proxy for the net harm to society caused by the fraud, and the government's simplified aim is to minimise fraud.

The first objective function -- Minimise expected total fraud -- corresponds to a strong focus on deterrence. Once a contractor commits fraud, society sustains the loss, regardless of ex-post detection or remediation. The fact that a contractor is successfully held liable for fraud

⁹⁶⁸ For the details of a Kwok model of *qui tam* enforcement see *infra*

⁹⁶⁹ In the model the government regulator is a hypothetical unified administrative body

after the fact does not make a significant difference to the government, preoccupied by prevention over imposition.

The second objective function -- Minimise total expected unrecovered fraud -- also focuses on deterrence, but it distinguishes between fraud that is detected and the one undetected. If fraud is successfully detected, this objective function suggests that the post-detection remediation is sufficient to offset the harm incurred by the commission of fraud. The calculation excludes the welfare of the contractors held liable for the fraud, as they will bear a substantial loss through this process.

The third objective function -- Maximise expected total fraud recovery -- stands similar to second option. This function suggests that the government can offset the losses due to fraud by recovering money from defendants. It is distinct, however, in what it considers the cost of paying the bounty to the successful relator. This option's objective can be referred as a mixed deterrence and compensation.

The fourth objective function -- Maximise expected fraud recovery -- presumes a bureaucratic body that narrowly focused strictly on fraud recovery. It does not consider the deterred fraud as part of its set of goals.

The next step in developing the effective enforcement model is to analyse the possible adjustments the government regulator can undertake.

The first, and probably an over simplistic solution, is **to increase a damage multiplier**. The traditional optimal deterrence argument is to maximise the penalty, since the penalty loss is

born primarily by the offender and does not require costly investment (in comparison to increasing the chance of detection). Increasing the damage multiplier would depress the expected value of fraud to the contractors. The ideal for deterrence would be to calibrate the penalty to the full wealth of the defendant, but considering the defendant's wealth in determining damages is a way to nowhere after the US Supreme Court ruling on the *State Farm*⁹⁷⁰. The FCA is a treble damages statute, so formal adjustments would require legislative change, but government officials might push for more expansive interpretation of damage estimates that would effectively increase the perceived multiplier. Nonetheless, besides the limitations under Supreme Court jurisprudence for high damage multipliers in civil litigation, one of the unintended consequences may be a reduction in a number of government contractors scared away by the severity of potential damages, with subsequent drop in competition leading to the rise in contractual prices⁹⁷¹.

The most strategically effective, but also the most complicated, would be a **policy aimed at increase in the probability of fraud detection**. The probability of detection and success in a model is a function of the amount of the fraud. The fact that the probability of detection can be calibrated to the level of harm allows the regulator to bypass wealth constraints in deterrence, assuming that it can raise detection to sufficient levels satisfying the reciprocal

⁹⁷⁰ The Supreme Court stated: "The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award." (*State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003)) The Court then noted, however, that while "[w]ealth provides an open-ended basis for inflating awards when the defendant is wealthy that does not make its use unlawful or inappropriate; it simply means that this factor cannot make up for the failure of other factors, such as reprehensibility, to constrain significantly an award that purports to punish a defendant's conduct." Ibid. See: Orr, L.C., *Making a Case for Wealth-Calibrated Punitive Damages*. 37 **Loyola of Los Angeles Law Review** 1739 (2004) [online], Available at: <<http://digitalcommons.lmu.edu/llr/vol37/iss5/10>> (accessed on 27 June 2015); Hylton, K.N., *A Theory of Wealth and Punitive Damages*. (forthcoming) [online], Available at: <<https://www.bu.edu/law/faculty/scholarship/workingpapers/documents/HyltonKWealthPunitives2REV.pdf>> (accessed on 27 June 2015)

⁹⁷¹ Kovacic (1996), *supra* note 578 at 128; and (1998), *supra* note 580 at 128

standard. The relator receives a bounty payment equal to a portion of the detected fraud. To increase the probability the government might adjust the relator's share of the recovery (in theory, up to the entire amount of the current treble damages). A higher share of the recovery might cause marginal relators to step forward with information.

A government operating under objective options 1 or 2 may grant relators the full amount of the recovery, since the government's share of the recovery is not part of the objective function. Other considerations might limit this full grant. Firstly, the government, if it does not receive any funds, might be concerned about backroom deals between relators and contractors. Secondly, it may face a challenge of being overloaded by a wave of tips.

It is at this point, where the Kwok's model attracts most academic criticism. Not all researchers in the field share his approach that concludes with an optimistic sequence: the higher rewards increase reporting, that leads to increased enforcement, and therefore increased deterrence⁹⁷².

A basic rational-choice perspective assumes that whistleblowers gamble the personal and professional cost of reporting misconduct against potential payouts. Where rewards are too low or uncertain or retaliation protections too anemic, the system will not generate enough tips⁹⁷³. Providing too many incentives or protections, however, risks overloading the system,

⁹⁷² Casey, A.J. and Niblett, A., *Noise Reduction: The Screening Value of Qui Tam*, 91 **Washington University Law Review** 5 (2014), p. 1175; Also: Engstrom, D.F., *Whither Whistleblowing? Bounty Regimes, Regulatory Context, and the Challenge of Optimal Design*, 15 **Theoretical Inquiries in Law** (2014) 605-633

⁹⁷³ Rose, A., *Better Bounty Hunting: How the SEC's New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 **Northwestern University Law Review** 4 (2014) 1235-1302; Ferziger, M.J. and Currell, D.G., *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, **University of Illinois Law Review** (1999) 1141

overwhelming an agency tasked with sifting good and bad tips⁹⁷⁴. As Engstrom points out, the concern is not just about higher administrative or other transaction costs that push the social cost of enforcement beyond its benefit⁹⁷⁵. In his words, “it is a deeper, and paradoxical one”⁹⁷⁶. A budget-constrained agency that enjoys a surge of tips faces a choice: either to ignore some of them and, using a triage approach, to focus efforts on a subset of tips; or to allocate fewer investigative resources to each of the additional tips, thus degrading the accuracy of its screening efforts. The perverse result is that by reducing the certainty with which wrongdoing is detected and therefore the probability that any given malfeasor will be made to internalise the costs of its misconduct, more whistleblowing may eventually yield less overall deterrence⁹⁷⁷.

Kaplow and Shavell developed a model, showing that lower adjudicatory accuracy -- whether false positives or false negatives -- lowers deterrent effects⁹⁷⁸. The theory that more whistleblowing may bring about decrease in deterrence rests on an assumption that there is a point at which additional tips will decrease the likelihood that a firm’s misconduct will be accurately identified and sanctioned more than they increase the probability that the firm’s misconduct is the subject of a tip at all. But as Engstrom comments, from a social planner perspective, the more important concern in this regard may be the social optimality of the deterrence additional tips yield. These additional tips may, by reducing the accuracy of an agency’s decision to enforce, create social loss by deterring socially productive and

⁹⁷⁴ Ferziger and Currell, *supra*, p. 1172

⁹⁷⁵ Engstrom, *supra* note 978 at 613

⁹⁷⁶ *Ibid.*

⁹⁷⁷ Casey and Niblett, *supra* note 972 at 1172

⁹⁷⁸ Kaplow, L. and Shavell, S., *Accuracy in the Determination of Liability*, 37 **The Journal of Law and Economics** 1 (1994) 1-15

completely legal activity, offsetting welfare gains from deterred misconduct⁹⁷⁹. Notably the analysis becomes more complicated when the model allows the agency to allocate its scarce resources between investigatory and enforcement effort. It deviates from the Kwok model's option 1 and 2 analyses at the point, when an agency is allowed to receive some portion of the monetary fines it imposes, thus making analysis overelaborated⁹⁸⁰.

However, when Casey and Niblett insightfully connect tip volume, sanction certainty, and deterrence, they come to the conclusion that a *qui tam* mechanism will yield systematically better information than a simple cash-for-information reward system⁹⁸¹. They view advantage of the *qui tam* in inherent to the FCA's *qui tam* structure loss-contingent costs rule: the costs of reporting misconduct, and not just the benefits of doing so, are dependent on relator's success via the reverse fee-shift for frivolous claims, stipulated by the False Claims Act⁹⁸². Provided by a *qui tam* regime's deployment of plaintiff-side counsel necessarily delivers higher-quality information. Relators have strong incentives to engage in careful pre-filing inquiry to distinguish their tips from the pack or avoid pouring valuable resources into hopeless cases⁹⁸³. In more details the role of law firms specialising in *qui tam* litigation is analysed in this section below.

Under option 3, the marginal responsiveness of the relators to increased bounty share

⁹⁷⁹ Engstrom, *supra* note 978 at 614

⁹⁸⁰ Kaplow and Shavell, *supra* note 978 at 10

⁹⁸¹ Casey and Niblett, *supra* note 972 at 1174

⁹⁸² *Ibid.*; As opposed to the English rule, which routinely permits fee-shifting, in the US attorney's fees generally are not a recoverable cost of litigation "absent explicit congressional authorization". See, *Key Tronic Corp. v. United States*, 511 U.S. 809, 814-815 (1994) (holding that the phrase "any other necessary costs of response incurred by any other person" in §107 of the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §9607, does not include attorneys' fees). As stated in *Alyeska Pipeline Service Co. v. Wilderness Society*, "In the United States, the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the loser." (421 U.S. 240, 247 (1975))

⁹⁸³ Rose, *supra* note 973 at 1279; Engstrom, *supra* note 441 at 105

becomes important. To the extent the relators are motivated by the actual amount of the fraud rather than their particular share of the recovery, increasing their bounty share might not make sense to such a government. One example of such a relator would be a well-to-do idealist whose concern is primarily stopping large fraudsters. That in fact was a predominant way the regulators pursued in battling the fraud throughout the last hundred years, and that policy of moral encouragement of whistle-blowers proved to be a limited success.

Recently, however, an emerging literature exploring the complex interaction of material and moral incentives to report wrongdoing, have shed a new light on the possibility that material rewards may “crowd out” moralistic motivation to surface information about misconduct -- particularly where bounties are relatively small. The underlying logic of this hypothesis is that offering bounties reduces the moral valence of the misconduct by commodifying the system. This assumption might be more plausible where rewards are low, which both commodities the system and at the same time signals that the misconduct is not severe enough to warrant a substantial payout⁹⁸⁴.

This crowd-out effect can set what amounts to a lower-bound on the efficient reward level: offering rewards below this level will produce no net increase in tips’ volume, or their quality, and at greater cost to the government; or, worse, a net decrease in revealed information. Feldman and Lobel in their research confirmed that reporting levels were “even lower than situations where no incentive was present” where their survey respondents were offered a

⁹⁸⁴ Feldman and Lobel, *supra* note 568, at 1155 (reporting experimental findings that low monetary incentives “crowd out, or suppress, internal moral motivation”). For more law and economics analysis, see Titmuss, R., (1997). *The Gift Relationship: From Human Blood to Social Policy*. New Press; Mellstrom, C. and Johannesson, M., *Crowding Out in Blood Donation: Was Titmuss Right?* 6 **Journal of the European Economic Association** 4 (2008) 845-863 (more skeptical about crowding out effect)

low reward and had a low perception of the misconduct's severity⁹⁸⁵. In this case again, rewards and protection from retaliation — though both shape the whistleblower cost-benefit calculus — may not be perfect substitutes. Under limited circumstances where the crowd-out risk is present, fortifying retaliation protections may in theory draw more information into the system than raising rewards. As Engstrom speculated, “the best way to achieve an optimal amount of information revelation in some regulatory regimes may be not to offer bounties at all”⁹⁸⁶. At present no research can prove that the ethics-based calculus of moralistic whistleblowers will generate systematically better information about misconduct than the instrumental calculus of materialistic whistleblowers.

Outside of manipulating the relator's reward share, the government might be able to shift the probability of success through procedural or resource benefits, thus enticing greater relator participation. A government that shares information resources provides assurances regarding confidentiality and security, or helps in the settlement/negotiating process may induce higher probabilities of people becoming relators. But as shown over the last 15 years after the enactment of the Sarbanes-Oxley Act, the effectiveness of such policy was remarkably modest⁹⁸⁷.

The third available policy to increase fraud deterrent, according to the model, will be **the optimisation of contract distribution**. Under this regime, it is in the society's interest to avoid any contracts in which potential fraud may exceed the expected social value. The simple way to achieve this is to maximise contract sizes. A similar result will be achieved through consolidation of liability for fraud, when government deliberately reduces its contractors'

⁹⁸⁵ Feldman and Lobel, *supra* note 568 at 1194

⁹⁸⁶ Engstrom, *supra* note 978 at 616

⁹⁸⁷ See Chapter I

base to a smaller number of large corporations, and concurrently generously extends their liability for fraud, for example, by adopting the longer statutes of limitations that would help magnify the amount of fraud liability.

The trade off would be deviation from the theoretically optimal contract base, as society would be receiving less value from these contracts. This may be, as shown above, due to reduced competitiveness of the market, and the reduced diversity of contractors that can precisely satisfy a broad range of desirable attributes such as ownership diversity, capability, and geography.

Beyond the technical constraints, increasing liability for fraud is also constrained by defendant's liquidity. If the statute of limitations is relatively large, a company may become effectively judgment proof due to the accumulating liability for large damages the company would not be capable to cover.

As the model shows, the most viable answer to the political, economic and societal necessity to increase the fraud detection and deterrence without recourse to additional budget financing the Coasean government can offer is to widen the scope and scale of *qui tam* mechanism.

Regulation scholars have often observed that budgetary limitations are a core and recurring constraint on the administrative state's enforcement capacity⁹⁸⁸. The growing disparity

⁹⁸⁸ Gilles (2000), *supra* note 517 at 115; Rajabiun, R., *Private Enforcement and Judicial Discretion in the Evolution of Antitrust in the United States*, 8 **Journal of Competition Law & Economics** 187 (2012), p. 214 n.110 (“[I]n his testimony to Congress in 1951, Assistant Attorney General H. Graham Morrison argued that, in the absence of private suits, public enforcers would require four times as much funding”); Rose-Ackerman, S., *Judicial Review and the Power of the Purse*, 12 **International Review of Law and Economics** 191 (1992); Sunstein, C.R., *What’s Standing After Lujan? Of Citizen Suits, “Injuries,” and Article III*, 91 **Michigan Law Review** 163 (1992)

between salaries offered by the government and remuneration packages available for skilled employees in the private sector restricts the government's ability to recruit and to retain the thousands of highly skilled people needed to perform investigations of corporate fraud. And the scope of this fraud increases following the growing intervention of the state in the economy and society. The only way for the government to attract the highly skilled people it needs to compete intellectually with corporate white-collar perpetrators⁹⁸⁹ is by increasing significantly the high end of the government salary scale, and presently it is a zero probability that Congress can be persuaded to enact into law a new salary structure with a high end that allows government to hire and to retain the kind of workforce the government seeks to employ to perform the complex investigations in house⁹⁹⁰.

The solution is to establish a *qui tam* as a standard mechanism of prosecuting corporate crime beyond the confines of fraud against government, thus encouraging private enforcement to employ vastly more resources, and potentially mobilising private relators and plaintiffs' attorneys in numbers that sufficiently enhance agency capacity both quantitatively and qualitatively⁹⁹¹. Such development embodies the concept of private-public enforcement model, which from law and economics perspective offers the most efficient solution to tackle white-collar crime.

The above rendered theoretical reasoning has been corroborated by some empirical evidence. As showed by the first large-scale empirical study of the *qui tam* regime since --

⁹⁸⁹ On white-collar crime see below this Chapter

⁹⁹⁰ Pierce Jr., R.J., Book Review: *Outsourcing Sovereignty: Why Privatization Threatens Democracy*, 76 **George Washington Law Review** 1216 (2008)

⁹⁹¹ Coffee, Jr., J.C., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working*, 42 **Maryland Law Review** 215 (1983); Gilles (2000), *supra* note 517 at 115; Roach K. and Trebilcock, M.J., *Private Enforcement of Competition Laws*, 34 **Osgoode Hall Law Journal** 461 (1996); Stewart and Sunstein (1982), *supra* note 590 at 130

after a long period of desuetude -- Congress substantially amended and revived the FCA in 1986⁹⁹², the growing number of law firms specialising in *qui tam* litigation plays generally positive role in law enforcement⁹⁹³.

Using an original data set encompassing more than four thousand unsealed *qui tam* lawsuits filed between 1986 and 2011 — from the most routine and least visible cases to the blockbuster, nine-figure settlements — the analysis provided a remarkable portrait of *qui tam* litigation that goes well beyond existing mostly theoretical studies and some anecdotal accounts. By focusing on the role of expertise and specialisation among *qui tam* enforcers the research quantified the repeat-play advantage among *qui tam* counsel by reporting litigation outcomes broken out across four tiers of relator counsel: “Super” repeat firms (forty or more cases across the period 1986–2011), “Heavy” repeat firms (10-39 cases), “Regular” repeat firms (2-9 cases), and “One-Shot” firms⁹⁹⁴. The success of the counsel was measured by the Department of Justice (DoJ) intervention rate (as proof of robustness of evidence collected), and imposition rate (as measure of public significance).

Both intervention and imposition rates show a clear downward cascade from more to less experienced *qui tam* relator counsel, with “Super” counsel roughly 1.5 times more likely to win DoJ intervention (37.1% versus 22.6%) and achieve impositions (40.7% versus 29.0%)⁹⁹⁵. The substantial differences in imposition sizes were even more significant: “Super” counsel have achieved impositions that are roughly four to five times that of one-shotter counsel,

⁹⁹² See Chapter I

⁹⁹³ Engstrom, D.F., *Harnessing the Private Attorney General: Evidence from Qui Tam Litigation*, 112 **Columbia Law Review** (2012) 1244-1296

⁹⁹⁴ The allocation was retrospective. See, Engstrom, *supra* note 978 at 1299

⁹⁹⁵ *Ibid.*

whether calculated on a per-win basis (\$28.6 million versus \$7.3 million), or a per-filing basis (\$11.7 million versus \$2.1 million)⁹⁹⁶. And more experienced firms bring larger cases, achieving an average of \$1.8 million and \$0.6 million more for every ten cases in the firm's past case portfolio on a per-win and per-filing basis, respectively⁹⁹⁷.

Counsel specialisation and experience proved to be an important factor of success within the *qui tam* regime.

The data also shows a fledgling trend of concentration at the top end of the organised relators' bar, with the top ten firms accounting for substantially more filings (625) than the next fifteen firms (484)⁹⁹⁸. Top relator firms (twenty-five or more filings) are roughly 4% more likely to win DOJ intervention and 3% more likely to win impositions, and also achieve impositions that are roughly \$12 million and \$4 million larger on a per-win and per-filing basis, respectively, with all results statistically significant⁹⁹⁹.

The research provides substantial empirical evidence to draw some conclusions in respect of the critique the *qui tam* legal practice attracted from some legal scholars¹⁰⁰⁰.

First, a claim that more experienced firms are turning into "filing mills" has not been substantiated so far. Rather the opposite, such firms bring in with deeper specialisation better

⁹⁹⁶ *Ibid.*, p. 1300

⁹⁹⁷ *Ibid.*, p. 1311 (The latter of the two misses statistical significance, though narrowly, even at the less conventional 90% level)

⁹⁹⁸ *Ibid.*, p.1302. Success rates among the top twenty-five relator firms are highly variable, whether looking at intervention and imposition rates, or per-filing imposition amounts. Among firms with twenty-five or more filings, the clear industry leaders in consistently achieving DOJ intervention and impositions are Vogel, Slade and Goldstein (63.0% intervention rate; 65.9% imposition rate), Phillips and Cohen (52.8% intervention rate; 59.2% imposition rate), and Wilbanks Bridges (52.0% intervention rate; 61.9% imposition rate)

⁹⁹⁹ *Ibid.*, p.1313

¹⁰⁰⁰ See Chapter II

expertise, broader understanding of the respective sector, professional skills, which yield higher quality of filings, and subsequently secure higher rate of success.

Second, professionalisation in the form of the so-called repeat relators does not provide strong evidence to the claim that they present an obvious drag on the *qui tam* system. Repeat relators are, all else equal, significantly less likely to win intervention from the Department of Justice, or impositions. But when they win, they achieve substantially larger impositions than one-shotters. The result is that repeat relators recover \$5.4 million more than one-shotters per case filing¹⁰⁰¹.

Third, concern about “revolving door” capture turned out to be exaggerated. It seems that former DOJ insiders are more likely indeed to achieve intervention of the enforcement agency, but allocation of scarce enforcement resources by the Department appears to be generating lower returns in cases initiated by its former employees. Holding all other variables (including firm experience) steady, the models imply that relator counsel with prior DOJ experience are roughly 17% more likely to win its intervention and impositions¹⁰⁰². But as data shows, when they win, former DOJ insiders achieve impositions that are \$10.6 million and \$3.4 million smaller on a per-win and per-filing basis, respectively, than those achieved by their non-insider counterparts, with both results statistically significant¹⁰⁰³. In *qui tam*

¹⁰⁰¹ Engstrom, *op. cit.* p. 1314

¹⁰⁰² Morris, J.C., Note, *Civil Fraud Liability and Iraq Reconstruction: A Return to the False Claims Act's War-Profiteering Roots?* 41 **Georgia Law Review** (2007) 623-646; Engstrom, D.F., *Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation Under the False Claims Act*, 107 **Northwestern University Law Review** 4 (2013) 1689-1756; For broader methodological discussion, see Angrist, J.D. and Pischke, J-S., (2009). *Mostly Harmless Econometrics: An Empiricist's Companion*. Princeton University Press, [online] Available at: https://www.researchgate.net/profile/Joshua_Angrist/publication/51992844_Mostly_Harmless_Econometrics_An_Empiricist's_Companion/links/00b4953344a9a0cb13000000.pdf?origin=publication_detail. Accessed on 17 September 2016

¹⁰⁰³ Engstrom, *supra* note 978 at 1315

litigation the key role to play is designed for the insider from the company-perpetrator, and not for the law enforcement insider. Coupled with a high entry barrier and potential additional costs if lost the *qui tam* mechanism has in-built limits on overzealous enforcement.

The *qui tam* enforcement can actually increase the efficient use of scarce administrative resources by allowing administrators to focus enforcement efforts on low-level violations that do not provide adequate incentives for private enforcement, while resting assured that those that do will be prosecuted by private litigants¹⁰⁰⁴. The next section will focus the analysis to the factors and circumstances that affect the decision of those who play the key roles in private law enforcement -- potential litigants in *qui tam* cases, or simple whistle blowers under bounty regime -- to come forward.

Economic Analysis of *Qui Tam* Relators' Behaviour

For traditional economic analysis of law, the starting point of predicting behaviour is the belief that individuals respond to rewards and sanctions in a remarkably standard manner. According to this traditional view, individuals will report non-compliance, if the benefits from legal rewards, or the costs of legal liability, exceed the costs of reporting¹⁰⁰⁵. However, social scientists increasingly recognise that the motivation for compliance, as well as reporting non-compliance, frequently complicates a simplistic cost-benefit analysis¹⁰⁰⁶. Instead, as recent behavioural studies show, people appear to evaluate legal compliance under a more nuanced

¹⁰⁰⁴ Shermer, S.D., *The Efficiency of Private Participation in Regulating and Enforcing the Federal Pollution Control Laws: A Model for Citizen Involvement*, 14 **Journal of Environmental Law and Litigation** 461 (1999)

¹⁰⁰⁵ Most basically, this model was elaborated in the context of compliance and crime, see Becker (1968), *supra* note 830 at 178

¹⁰⁰⁶ Friedman, L. M., *Coming of Age: Law and Society Enters an Exclusive Club*, 1 **Annual Review of Law and Social Science** 1 (2005)

cost-benefit scale that includes elements that are foreign to pure economic analyses: duty and legitimacy¹⁰⁰⁷. It would be a mistake though to assume that altruistic motivation and high moral ground at least partly deny purely materialistic rationale. The picture turned out to be even more complicated, with more consideration given to the context, where a range of factors - individual, organisational, and legal environments – may impact decision-making of a potential whistle-blower/relator¹⁰⁰⁸. This logic intercepts with the Austrian conceptual framework in social, economic and legal analyses.

In Austrian perspective, a society's legal system has no existence apart from the subjective preferences and the conduct of the individuals who constitute that society. The evolution of such a system is open-ended and unpredictable. In Hayek's vision, it is not clear what the original purpose of the law was¹⁰⁰⁹, because the law emerges as the result of "human action, not human design"¹⁰¹⁰. Legal rules and institutions are determined as part of an on-going social learning and adaptation process which operates through trial and error, experimentation, imitation and compromise.

At the same time, the economic behavioural approach is being increasingly affected by the new governance theory in socio-legal studies, which rejects the idea that employee behaviour

¹⁰⁰⁷ Tyler, T. R., and Fagan, J., *Legitimacy and Cooperation: Why Do People Help the Police Fight Crime in their Communities?*, 6 **Ohio State Journal of Criminal Law** 231 (2008); Wenzel, M., *The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity*, 87 **Journal of Applied Psychology** 629 (2002); Murphy, K., *Regulating More Effectively: The Relationship Between Procedural Justice, Legitimacy, and Tax Non-Compliance*, 32 **Journal of Law and Society** 562 (2005); Gibson, J. L., *The Legitimacy of the U.S. Supreme Court in a Polarized Polity*, 4 **Journal of Empirical Legal Studies** 507 (2007). For an empirical demonstration of the limits of traditional economic models in the context of legal compliance, see Feldman, Y., and Teichman, d., *Are all Legal Probabilities Created Equal?*, **New York University Law Review** (2009)

¹⁰⁰⁸ Feldman, Y. and Lobel, O., *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties and Protections for Reporting Illegality*, 88 **Texas Law Review** 1151 (2010)

¹⁰⁰⁹ Hayek talks about the «purposeless common law»

¹⁰¹⁰ Hayek, F.A. (1960). *The Constitution of Liberty*, Routledge and Keagan Paul, London, p.35

within organisations is “reducible to individuals and their characteristics.”¹⁰¹¹ It further rejects the idea that institutions are simply the object of regulation. Instead, the lens of new governance theory is a systemic mapping of the range of possibilities in the interaction between regulation and regulated parties¹⁰¹². New governance scholars call for an understanding of the regulatory process as consisting of a range of possible tools and mechanisms, each with its comparative advantages and costs. The new governance lens thus helps to frame the inquiry about the possible incentives that can be applied by law to encourage certain behaviours, including reporting fraud.

As a result the economic method goes beyond individual behavioural analysis, which presumes the behaviour is shaped by isolated decisions of individuals. The institutional and legal environment also affects those decisions¹⁰¹³. At the moment the organisational theorists have come to consensus that “structures, processes, and tasks are opportunity structures for misconduct because they provide (a) normative support for misconduct, (b) the means for carrying out violations, and (c) concealment that minimises detection and sanctioning.”¹⁰¹⁴ For example, studies show that organisations, which constantly pressure their employees to meet unreasonable expectations, can lead employees to resort to illegal means to achieve these goals¹⁰¹⁵. Similarly, recent studies point to counterproductive effects of regulation,

¹⁰¹¹ Tillman, R. and Pontell, H.N. *Organizations and Fraud in the Savings and Loan Industry*, 73 **Social Forces** 1439-63 (1994)

¹⁰¹² Salamon, L.M., (2002). *The Tools of Government: A Guide to the New Governance*. Oxford University Press, pp.1-14

¹⁰¹³ Amir, O. and Lobel, O., *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy*, 108 **Columbia Law Review** 2098 (2008); Vaughan, D., *Toward Understanding Unlawful Organizational Behavior*, 80 **Michigan Law Review** 377 (1982); Janis, I.L., (1982). *Groupthink: Psychological Studies of Policy Decisions and Fiascoes*. Cengage Learning

¹⁰¹⁴ Vaughan, D., *The Dark Side of Organizations: Mistake, Misconduct, and Disaster*, 25 **Annual Review of Sociology** 271 (1999)

¹⁰¹⁵ Clinard, M.B., (1983). *Corporate Ethics and Crime: The Role of Middle Management*. SAGE Publications; Tyler, T. R., (2006). *Why People Obey the Law*. Princeton University Press

when the regulatory action is perceived as illegitimate and creates resistance within private actors¹⁰¹⁶.

The fact that organisational culture plays significant role in determining the behavioural choices of the employees returns the research into *qui tam* relators' motivation back to the more narrow economic analysis. In corporations, particularly financial institutions, with strong organisational culture of personal achievement, and where success is understood as a purely financial, materialistic success, the predominant pattern of behaviour is earning money. In such environment the calculative approach becomes almost universal, expanding to the decision making in respect of potential whistleblowing. In an environment where money is a core organisational value, and bonus is an ultimate reward; the traditional conceptual framework of law and economics has lost none of its relevance.

The *qui tam* enforcement mechanism rests on two pillars – the government law enforcement and a private party, a relator, whose role is crucial in providing the state authority with information about wrongdoing. The law firms assisting the relators play important role in the process, particularly in case the relators pursue litigation on their own with the Department of Justice withholding its support, but that role is still ancillary to the one of relators'. From the government's point of view therefore it is of a vital importance to develop an efficient system of incentives to entice/awe potential relators into reporting. Before starting a drill into mind-set of a potential *qui tam* relator, it is worth noting that although the significance of social enforcement and regulatory incentives is very high, there is no clear knowledge on the comparative advantages of the many of regulatory tools available for providing such

¹⁰¹⁶ Lobel, O. *Interlocking Regulatory and Industrial Relations: The Governance of Workplace Safety*, 57 **The Administrative Law Review** 1071 (2005); Lobel, O. *The Four Pillars of Work Law*, 104 **Michigan Law Review** 1539 (2006)

incentives. Despite this vast complexity, however, the current landscape of incentive programmes nonetheless reveals several prototypes that may provide some structure to the regulatory toolbox. The most widely used strategies are ensuring employees with anti-retaliation protection, enacting an affirmative duty to report, imposing liability for failure to report, and incentivising reporting with pecuniary rewards. Some statutes include several of these legal categories, whereas others offer only one of these alternatives.

This part aims to provide a comparative cost and benefit analysis of being a whistle-blower or a *qui tam* relator. Whatever the regulatory regime exists, and whatever factors are in play shaping behaviour of corporate employees exposed to fraud in which their employers are complicit, the decision to expose wrongdoing will be made on a basis the costs of blowing the whistle do not mean financial ruin or precipitous downsizing. For the purposes of this analysis the financial, and broader pecuniary, factors will be complimented by the less tangible ones such as career development or potential imprisonment, and purely intangible such as moral satisfaction. However, the assumption gives the financial balance a determinative role in decision-making.

The costs of delation

The costs comprise economic and non-economic costs. The analysis starts with the economic ones, which objectively verifiable and consist of past, current and/or future monetary losses.

Immediate monetary costs: the costs that can be easily monetised and therefore can be easily calculated. The current regulation on compensation usually includes one or more of them.

Loss of employment, reduction of wage: the existing legislation provides some relief for these immediate costs to the whistle-blower. When there is no law to explicitly prohibit unfairly

retaliatory dismissal, the courts developed a body of rulings against retaliatory termination of employment. However, potential whistle-blower should expect to seek a judicial relief anyway (see below).

Costs of making the complaint and possible litigation: lawyer fees, expert fees and other expenses come at a great cost. The existing whistle-blower protection legislation provides some remedy, but the legislation remains patchy (see below).

Like many other statutes in the fields of environmental, consumer, and financial regulation, the 2009 Stimulus bill offers traditional anti-retaliation protection: non-federal employers may not retaliate against individuals who reasonably believe that there has been a legal violation in their organisation and take action to report the violation¹⁰¹⁷. As such, the reporting individuals are protected by law against any adverse action by their superiors, be it firing, demotion, or acts of harassment. Many of these reporting protections were developed in response to corporate scandals such as Enron and WorldCom, where employer retribution threats persuaded employees to “swallow the whistle.”¹⁰¹⁸ Consequently, these statutes are designed to provide individuals with broad anti-retaliation measures. In contrast to the whistle-blower protections for federal employees, the American Investment and Recovery act explicitly extends protection for disclosures made during the course of an employee’s duties. Important example is found in the 2002 Sarbanes-Oxley Act (SOX), which protects corporate whistle-blowers when they report financial misconduct to the SEC or internally within their organisation.

¹⁰¹⁷ The American Recovery and Reinvestment Act , Pub. L. No. 111-5 (Enacted 111 H.R.1), § 1553 (2009)

¹⁰¹⁸ Feldman and Lobel (2010), *supra* note 970 at 220, p. 8

Hailed by scholars as “the gold standard of whistle-blower protection,” SOX provides civil remedies for individuals who experience retaliation in reaction to such reporting and makes it a felony to act against such an individual¹⁰¹⁹. Despite their prominence, existing legal protections for reporting misconduct are largely unsettled and still debated¹⁰²⁰. Anti-retaliation protections have developed as a patchwork of state and federal statutory and common law exceptions to the employment at-will regime, a century-old default rule that has allowed employers to terminate their employees “for good cause, for no cause, or even for morally wrong cause.”¹⁰²¹ As early as the 1930s, and significantly more since the 1960s and 1970s, legislatures have carved away at this default by enacting laws that grant employees rights against discharge¹⁰²². These federal statutes include anti-retaliation provisions designed to enable employees to claim their rights and report illegal conduct without fear of retribution¹⁰²³. These statutes encompass a broad range of regulatory fields, including financial, environmental, consumer, health and safety regulation¹⁰²⁴.

As a parallel development to legislative protections for whistle-blowers, courts have also developed the tort of wrongful termination, which allows plaintiffs to overcome the hurdle of at-will employment by claiming they were discharged for engaging in social enforcement

¹⁰¹⁹ Kohn, M. et al., (2004). *Whistleblower Law: A Guide to Legal Protections for Corporate Employees*. Praeger

¹⁰²⁰ Kohn, J. P., *Fuzzy Legality in Regulation: The Legislative Mandate Revisited*, 23 **Law & Policy** 469 (2001)

¹⁰²¹ *Payne v. Western & Atl. R.R. Co.*, 81 Tenn. 507, 519-20 (Tenn. 1884)

¹⁰²² Civil Rights Act of 1964 (Title VII), 42 U.S.C. § 2000e-2(a)(1) (1988); National Labor Relations Act, 29 U.S.C. §§ 151-69 (1935)

¹⁰²³ Occupational Safety and Health Act, 29 U.S.C. §660(c) (1988); Polygraph Protection Act of 1988, 29 U.S.C.A. §§2001-2009 (1988); Civil Service Reform Act, 5 U.S.C. §2302(b)(8)(A) (1988) (protecting federal employees from being terminated for blowing the whistle)

¹⁰²⁴ Energy Reorganization Act, 42 U.S.C. §5851(a) (1988) (prohibiting retaliation against whistleblowers); Asbestos School Hazard Detection & Control Act, 20 U.S.C. §3608 (1988) (prohibiting retaliation against whistleblowers reporting asbestos violations)

in the face of corporate misconduct¹⁰²⁵. Thus, even in a context where there exists no statute that provides anti-retaliation protection, courts have frequently held that individuals cannot be terminated by their employer for reporting legal violations¹⁰²⁶. In fact, retaliation is the fastest growing type of employment law claim¹⁰²⁷. However, courts significantly disagree over the scope of such protections¹⁰²⁸. At the constitutional level, the Supreme Court remains divided on what kind of reporting by public employees is constitutionally protected, holding in a split 4-5 decision that “when public employees make statements pursuant to their official duties, the employees are not speaking as citizens for First Amendment purposes, and the Constitution does not insulate their communications from employer discipline.”¹⁰²⁹ At the tort level, courts vary in the extent to which they are willing to extend anti-retaliation protections to different channels of reporting, different types of reported misconducts, and different categories of workers¹⁰³⁰.

Loss of invested capital in the company: ENRON and WorldCom collapses incurred heavy losses on their employees, and those who blew the whistle shared not only moral responsibility, but also a financial burden. The growing prevalence of performance based compensation schemes paid in options and stock, combined with company related pension

¹⁰²⁵ *Perks v. Firestone Tire & Rubber Co.*, 611 F.2d 1363 (3d Cir. 1979) (employee fired for exercising statutory right not to submit to polygraph test); *Reuther v. Fowler & Williams, Inc.*, 386 A.2d 119, 121-22 (Pa. S. Ct. 1978) (employee fired for performing jury duty)

¹⁰²⁶ *Ostrofe v. H.S. Crocker Co.*, 670 F.2d 1378, 1383-84 (9th Cir. 1982), *aff'd* 740 F.2d 739 (9th Cir. 1984) upholding claim of wrongful discharge for objecting to employer's violation of Clayton Act, despite lack of anti-retaliation clause in order to promote "interests of antitrust enforcement"), cert. denied, 469 U.S. 1200 (1985)

¹⁰²⁷ Retaliation charges for discrimination complaints have doubled in the past decade, now representing almost 30% of all discrimination claims. (*Charge Statistics FY 1997 through FY 2008* (2009) [online] Available at: <<http://eeoc.gov/stats/charges.html>> (accessed on 16 May 2011)

¹⁰²⁸ Feldman and Lobel (2010), *supra* note 970 at 220, p. 9

¹⁰²⁹ *Garcetti v. Ceballos*, 547 U.S. 410, 421 (2006)

¹⁰³⁰ Feldman and Lobel (2010), *supra* note 970 at 220, p. 9

funds lead to employees having a very large part of their capital invested in their employer¹⁰³¹. Even if a company does not go bust as a result of a fraud exposure (so far it remains an exceptional consequence of whistleblowing acts) the almost inevitable drop in its capitalisation hits a whistle-blower. At the moment there is no remedy to this financial loss.

The loss of human capital: One of the most important costs to a whistle-blower. In most cases whistleblowing brings about reputational damage, and puts an end to the careers of those who exposed corporate wrongdoing. Usually whistle-blowers rarely find a new job in the industry¹⁰³². And even if they are lucky enough to stay, or be reinstated on their positions, chances to further advance in their careers are close to zero¹⁰³³. The whistle-blowers are doomed to be blacklisted – put on the “black list” of the “not to be employed”¹⁰³⁴. Although they did the right thing, they are considered disloyal employees and a potential liability, “a troublemaker”¹⁰³⁵. Partly this fear and partly the informal boycott by the “old boys” network in the industry make a further career in the same field virtually impossible¹⁰³⁶.

Another factor contributing to this expulsion is that the possible collapse of a fraudulent company will make any working experience in it suspicious, thus making a devastating blow on all working experience of its employees¹⁰³⁷. This may be the most important cost to the

¹⁰³¹ Meulbroek, L.K., *Company Stock in Pension Plans, How Costly is it?* (March 2002), Harvard Business School Working Paper No. 02-058, AFA 2003 Washington, DC Meetings, HBS Finance Working Paper No. 02-058, [online] Available at: <<http://ssrn.com/abstract=303782>> (accessed on 2 October 2010)

¹⁰³² The lawyer of James Bingham, a whistleblower in the Xerox case, sums up his client’s situation as: “*Jim had a great career, but he’ll never get a job in Corporate America again.*” in Dyck *et al.* (2010), *supra* note 13 at 10

¹⁰³³ Cavico, F., *Private Sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 **South Texas Law Review** 545 (2004)

¹⁰³⁴ Glazer, M. R., and Glazer, P. M., (1989). *The Whistleblowers: Exposing Corruption in Government and Industry*. Basic Books, New York, p.281

¹⁰³⁵ Bucy, P. H. *Carrots and Sticks: Post-Enron Regulatory Initiatives*, 8 **Buffalo Criminal Law Review** 316 (2004)

¹⁰³⁶ Alford, C.F., (2002). *Whistleblowers: Broken Lives and Organizational Power*, Cornell University Press, p.19

¹⁰³⁷ “No matter how virtuous the motives, whistleblowers often are committing career suicide.” In Clampitt, Ph. G., (2004). *Communicating for Managerial Incentives*, SAGE, p.75

corporate whistle-blower – particularly in finance and banking – where career planners often employ notorious HR techniques: “screening contracts” and “tournament style compensation”¹⁰³⁸.

The first technique implies that employees are screened in categories of initial low and initial high productivity. Both groups are offered a low wage (W1) as a starter for the initial period, which duration may be contractually specified, and maybe not. Only after promotion to the next career stage a significantly higher remuneration (W2) is on offer. In fact, this is a prolonged “probation” period, which can be spread over many years. Those of the beginners who don’t expect to be good enough to get promoted may stay on a low wage level W1. High productivity employees who believe in a high probability (Pr) to get promotion will work there in anticipation of a future higher wage. A simple equation reflects how ambitious financiers view their wages – a combination of a present one and the one expected in the future: $W = W1 + Pr (W2)$ ¹⁰³⁹.

From point of view of a whistle-blowing protection, this means that such employees will not be satisfied with compensation limited to just W1 (current low wage). Current wage loss is not sufficient as a basis to calculate compensation. The compensation formula must include expectations of a future promotion and a significantly higher remuneration package.

The other technique is the so-called tournament model¹⁰⁴⁰, where the motivation to exert effort today is the possibility of a much higher wage in the future. This expectation motivates employees to work much harder than their current salary justifies. The exorbitantly high

¹⁰³⁸ Lazear, E.P., (1995). *Personnel Economics*, MIT press, Cambridge, p.184

¹⁰³⁹ De Schepper, supra note 776 at 172

¹⁰⁴⁰ Lazear E.P. and Rosen, Sh., *Rank-Order Tournaments as Optimum Labor Contract*, 89 **Journal of Political Economy** 5 841 (1981)

future remuneration works as an encouraging carrot to lure low-level employees, and to motivate them to keep working hard in spite of a poor reward. This is said to be one of the reasons for the extreme high remuneration managers of big corporations receive – partly as a delayed compensation for the past efforts, partly as a demonstrative motivation of those below in the hierarchy to squeeze much more efforts from them than they are actually paid for¹⁰⁴¹.

As a result, employees in the big corporations will not accept their current salary as sufficient and fair enough compensation as their expectations include the delayed future remuneration package.

Another challenge for any potential whistle-blower is that the longer he or she works in a particular industry the more industry specific skills they acquire. These skills often will be useless outside their working environment, and pay off as long as they are employed in their industry. As Howse and Daniels (1995) noted, “high levels of firm -- or industry -- specific human capital, particularly when the costs of such investment are borne principally by employees in return for future compensation, increase the vulnerability of employees to retaliation”.¹⁰⁴² For potential whistle-blowers it is not only their immediate wealth being under threat, but their potential future earnings. The loss of an accumulated human capital¹⁰⁴³ might be the biggest cost the corporate whistle-blower will have to bear as a price of being a good citizen.

¹⁰⁴¹ De Schepper (2009), *supra* note 776, p.24

¹⁰⁴² Howse R. and Daniels, R.J., “Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy”, in Daniels R.J. and Morck, R., (Eds.) (1995). *Corporate Decision-Making in Canada*. University of Calgary Press, Calgary, pp.531-532

¹⁰⁴³ *Ibid.*, p.536

The non-economic costs -- the subjective non-monetary losses associated with blowing the whistle, hard to evaluate, but nonetheless a real cost to the whistle-blower.

Psychological pressure: "Usually the whistle-blower is not fired outright. The organisation's goal is to disconnect the act of whistleblowing from the act of retaliation, which is why so much legislation to protect whistle-blowers is practically irrelevant. The usual practice is to demoralise and humiliate the whistle-blower, putting him or her under so much psychological stress that it becomes difficult to do a good job"¹⁰⁴⁴.

Retaliation by the employer and even fellow employees can be subtle, or it can be rude. For instance, workplace harassment and threats devised to make a whistle-blower lose faith in the possibility of bringing it to a good end¹⁰⁴⁵. This building up of psychological pressure might even be as subtle as silent social ostracism¹⁰⁴⁶, excluding the employee in question from any social gatherings, e-mails, and carpools, and giving him or her 'the silent treatment'. Other nuisances might be transferring them to other locations, giving them a closet for office¹⁰⁴⁷, increased scrutiny, and investigation of their personal backgrounds to detract from their statements.¹⁰⁴⁸

Such psychological harassment is difficult to successfully prove and be protected against. The government cannot credibly protect the whistle-blower from this psychological stress. On top of that whistle-blowers are, quite often, at first branded as 'crazy' even by the authorities they report to. This all together can have devastating effects on the whistle-blowers and those

¹⁰⁴⁴ Alford (2002), *supra* note 1087 at 227, pp. 31-32

¹⁰⁴⁵ Dyck *et al.*, (2013), *supra* note 772 at 165

¹⁰⁴⁶ Kipling D. Williams, (2002). *Ostracism: the Power of Silence*, Guilford Press, pp.191-196

¹⁰⁴⁷ Alford (2002), *supra* note 1087 at 227, p. 32

¹⁰⁴⁸ Howse and Daniels (1995), *supra* note 1002 at 229, p. 533

close to them¹⁰⁴⁹. It is a serious cost to consider for any potential whistle-blower. Reinstating the whistle-blowers in their previous jobs could only lead to a continuation of this subtle daily torture.

Breaking loyalty and trust: The people the whistle-blowers denounce are their colleagues, their business relations, and even friends. Perceived duty of loyalty to friends and “benefactors” is a strong value, and breaking it is often seen as a social wrong¹⁰⁵⁰. Considering that the “moral duty to divulge” serves an abstract “public”, the action of divulging is directly detrimental to people the whistle-blower knows and may even cares for. This on its own might be enough to offset that “ethical” duty. Therefore it should be taken into account to correctly assess the non-economic costs the potential whistle-blower faces.

Civil and criminal liability: If whistle-blowers can still be sued according to ‘gagging clauses’ or other provisions in their employment contracts this would amount to another cost. A breach of contract is very likely as many contracts include confidentiality clauses and “all contracts of employment involve an implied ‘duty of fidelity’ which requires honest, loyal and faithful service and forbids competition with the employer”¹⁰⁵¹ Criminal liability for complicity is another possible cost. Often fraud is incrementally done step by step. However what starts out as a minor manipulation, might soon turn out to be large-scale fraud. To avoid employees suddenly being caught in a web of fraud, so they still dare to come out and blow the whistle, they should be convinced by giving them relief of complicity. If not, “the ‘leaders’ of the crime

¹⁰⁴⁹ Bucy, P.H., *Private Justice*, 75 **Southern California Law Review** No. 1, (2002), pp. 61-62

¹⁰⁵⁰ *Ibid.*, p. 54

¹⁰⁵¹ De Schepper (2009), *supra* note 776, p. 27

within the corporation have a strong incentive to induce other employees to engage in wrongdoing so as to immunise them against becoming whistle-blowers”¹⁰⁵².

The currently available benefits

Whistle blowing brings some benefits. For the purposes of this analysis the benefits are distributed into two groups: those to offset the economic costs and other benefits.

1. Benefits to offset the economic costs

Protection from being fired or demoted, and reinstatement: This by far the least realistic benefit in existing regulation, almost completely devoid of any realism. Regaining employment at your former seniority level or protection from dismissal are quite a poisoned benefit, as it puts a whistle-blower in an environment, which is in all probability, quite hostile. Psychological pressure would build up, with chances of ever advancing in the firm are almost negligible, and social ostracism hardly inconceivable. This “benefit” is therefore almost counterproductive, though found in many statutes and court rulings. As mentioned above, the focus of current regulation on this unrealistic “protection of current employment” could be regarded as an additional disincentive for the potential whistle-blower.

Compensation for loss of wage: a necessary compensation, which mitigates one of the immediate negative wealth effects of retaliation by dismissal or by reduction of wage. But the loss of the regular wage is often only a very small part of the actual loss if there are significant performance based element of the remuneration package, or as shown above there are strong expectations of the future pay rise. And very inadequate if screening contracts and

¹⁰⁵² Howse and Daniels (1995), *supra* note 1002 at 229, p. 538

tournament models are applied, making the current (low) wage a bad measure of the value lost by the employee.

Costs of making the complaint and possible litigation compensated: A clear benefit, which offsets the cost associated with pursuing the procedure of blowing the whistle. A necessary provision in any whistleblowing regulation, including both the PIDA and the SOX.

2. Other benefits

Moral satisfaction from doing a public good: This moral duty has played its part in the discussions leading up to the SOX and the PIDA¹⁰⁵³. It was even proposed to make it into a legal duty. While the moral duty to blow the whistle might be more significantly felt in situations with a health or disaster risk, posing a direct threat to colleagues, clients and general public, the public duty is quite ambiguous in respect of corporate fraud. No clearly defined duty exists as such. On top of that, as explained above, this duty is to the abstract “public”, while divulging information on corporate fraud is hurting an immediate circle of friends, colleagues and business relations. While there are people with very high ethical standards that would gladly risk it all for the public good, this should not be overestimated. “Moral crusaders” are a rare breed.

Compensation for psychological stress: Currently a rare benefit, due partly to the difficulty in proving causality, and partly to the underestimation of these types of subjective costs in whistleblowing, which are hard to evaluate and therefore often ignored¹⁰⁵⁴.

¹⁰⁵³ Rapp, G. Ch., *Four Signal Moments in Whistleblower Law: 1983-2013*. 30 *Hofstra Labor and Employment Journal* 389 (2013); Hochberg *et al.* (2009), *supra* note 821 at 174

¹⁰⁵⁴ Dyck *et al.*, (2010), *supra* note 13 at 10

Revenge: Controversial, but an important driving force behind some whistle-blower cases¹⁰⁵⁵, in which disgruntled (ex-)employees show a higher willingness to bear costs just to get back at their employer. Often cases driven by revenge are offered as exemplary whistleblowing cases¹⁰⁵⁶, leading to a very unbalanced estimation of what motivates the average employee whistle-blower.

Loss of civil and criminal liability: As clauses in the contracts and criminal liability often prevent the potential whistle-blowers from exposure. For civil liability this benefit is present in almost all systems. Explicitly the case in application of the SOX and PIDA by considering whistleblowing a protected right of the employee¹⁰⁵⁷. Criminal complicity is exonerated too in the application of the PIDA and the SOX¹⁰⁵⁸, but not in case of the Dodd-Frank Act *qui tam* provisions¹⁰⁵⁹.

A dilutor of the benefits: possible failure of procedure

In assessment of the benefits of blowing the whistle the probability of success plays an important role. If the chance is high that the complaint will be ignored or discarded, taking the risk of blowing the whistle is unappealing as the costs could be incurred without any of the benefits. *Qui tam* relation stays apart as it grants the opportunity to relators to pursue their case even when Department of Justice rejects the filing. A possible equation to represent a potential whistle-blower's approach would be: Expected benefit $E(B) = Pr.(B)$ and the

¹⁰⁵⁵ Clampitt (2004), *supra* note 997 at 227, p. 75

¹⁰⁵⁶ Ted Beatty at Dynegy, Ronald Secrist in the *Dirks vs. SEC* case; also see Kiefer, P. C., *A Question of Ethics: Whistleblowers*, Winter 2002, [online]. Available at: <<http://www.courtethics.org/Ethics%20Columns.htm>>, (accessed on 30 June 2010)

¹⁰⁵⁷ De Schepper (2009), *supra* note 776, p. 31

¹⁰⁵⁸ *Ibid.*

¹⁰⁵⁹ Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111–203, H.R. 4173

Expected incentive = (Probability of success) (Benefits) – Costs; $E(I) = Pr.(B) - C$. If the whistleblowing procedure has a high probability of success close to 1, the full benefits will be taken in account. If on the other hand probability is low due to consistent failure of the authorities this will be closer to 0, seriously diluting the benefits. This means that reincentivising whistle-blowers by emphasising the benefits only will still be a limited success, if the responsiveness of the authorities is low. However, in case of a *qui tam* mechanism, both the Expected benefit $E(B)$ and the Probability of Success $Pr(B)$ will be significantly higher. First, *qui tam* offers a significant financial reward -- higher than modest whistle-blower's compensation. Second, the probability of success is also higher due to its inherent right to prosecute even without consent of a government law enforcement agency.

It is clear from the cost-benefit analysis that the government is not offering significant reward for the valuable information the potential corporate employees can bring to consideration by its law enforcement agencies. The approach pursued by the state regulators is rudimentary inefficient with its focus on keeping the delating employees in their previous employment and securing them their current level of income within the framework provided by the anti-retaliatory legislation. Such approach completely ignores the loss of their human capital the relators suffer by turning into blacklisted zombies scaring away any potential employer.

Some researchers have shown that even modest statutory benefits currently provided by the government have very limited effect. Zingales (2004)¹⁰⁶⁰ summarises evidence on the consequences of whistleblowing for individual employees. In a 1992 survey of 1,500 federal workers, 25 per cent of employees reported that they experienced verbal harassment and

¹⁰⁶⁰ Zingales, L., *Want to Stop Corporate Fraud? Pay off Those Whistle-blowers*. AEI-Brookings Joint Center Policy Matters (18 January 2004)

intimidation; 20 per cent were shunned by co-workers and managers; 18 per cent were assigned to less desirable duties; and 11 per cent were denied a promotion. A 1998 survey of 448 emergency physicians paints an even worse picture: 23 per cent of those who complained about an issue reported having been fired or threatened with termination. Brikey (2003)¹⁰⁶¹ reports that a random review of 200 whistle-blower complaints filed with the National Whistle-blower Center in 2002 found that about half of the complainants said they were fired after they reported misconduct. The remaining complainants had been subjected to other retaliatory action such as on-the-job harassment or discipline. A survey by another watchdog group, the Government Accountability Project in 2005, found that about 90 per cent of whistle-blowers were subjected to reprisals and threats¹⁰⁶². It seems there is no much progress in improving the environment for honesty among corporate employees.

The complete lack of any compensation for losses of their invested capital and human capital, together with the lack of attention paid to non-economic damages makes the current cost-benefit analysis for potential whistle-blowers severely unbalanced in favour of not reporting the fraud. A leading benefit in the current protection approach -- protection of employment, reinstatement – cannot be regarded as a serious incentive to tip the balance, not even with the compensation of the loss of current wage. The consequence is that hardly any rational employee would seriously consider option to bring a delicate inside information on a fraudulent corporation to disposal of the public law enforcement. As Duck *et al.* put it in their seminal research, “given these costs, however, the surprising part is not that most employees

¹⁰⁶¹ Brickey, K.F., *From Enron to WorldCom and Beyond: Life and Crime after Sarbanes-Oxley*, 81 **Washington University Law Quarterly** 357-401 (2003) [online] Available at: <<http://dx.doi.org/10.2139/ssrn.447100>> (accessed on 7 September 2012)

¹⁰⁶² Moberly, R. E.. *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*. 49 **William and Mary Law Review** 65–155 (2007)

do not talk: it is that some talk at all.”¹⁰⁶³ Basically the dissenting employee has to start back from near zero, often in a completely unrelated field. Compensation based on current salary, and focused on reinstatement provides a poorly convincing incentive from this perspective.

The only way for the government agencies to gain unrestricted access to the pool of potential whistle-blowers in a corporate sector is to change its focus from providing protection to fully compensating the future dissenters. The compensation provisions should specifically include:

- Compensation for lost current wages
- Compensation for loss of invested capital
- Compensation for loss of invested human capital, the loss of future earning potential
- Compensation for any reasonable costs incurred for the procedure of delating and for the full compensation lawsuit
- Compensation for non-economic damages, such as psychological stress
- The relief of criminal and civil liability.

The only available mechanism capable to embrace all these provisions is *qui tam* in its generic form devoid of the focus on exclusively fraud against government. From this perspective, the adoption of bounty provisions by the Dodd-Frank Act was a step in a right direction. Only a *qui tam* mechanism with its emphasis on providing the relator with a share of recovery offers financial reward sufficient to offset all possible losses for a relator. As it was shown above, bounty systems prove their efficiency. When employees can bring a *qui tam* suit that the company has defrauded the government, whistle-blowers stand to win – as research of Dyck *et al.* shows, on average the sample of successful *qui tam* whistle-blowers collect \$46.7

¹⁰⁶³ Dyck *et al* (2010), *supra* note 13 at 10

million¹⁰⁶⁴. According to the data of the Department of Justice, Total False Claims Act recoveries (Federal and State) since the 1986 amendments revitalised it exceeded \$24 billion. In average, in the healthcare the US Government is recovering \$15 back for every \$1 invested in False Claims Act health care investigations and prosecutions. The average relator award when the Department pursued the case is 16.84% of funds recovered¹⁰⁶⁵.

The recent cases of such rewards speak for themselves:

- UBS Swiss banker Bradley Birkenfeld¹⁰⁶⁶ won the largest reward ever paid to an individual whistle-blower: \$104 million dollars obtained under the IRS tax fraud whistle-blower rewards programme, which was scaled after the *qui tam* rewards provisions;
- In October 2010, Cheryl Eckard, a former GlaxoSmithKline employee, won \$96mln, which is believed to be the largest reward ever given to an individual US *qui tam* relator. The award is part of a \$750mln settlement over the company's manufacturing practices in Puerto Rico¹⁰⁶⁷. The award may well be increased by bounties paid by various states;
- In September 2009 John Kopchinski a former Pfizer sales representative earned more than \$51mln¹⁰⁶⁸.

¹⁰⁶⁴ *Ibid.*, p.44

¹⁰⁶⁵ Taxpayers Against Fraud, 18 August 2010

¹⁰⁶⁶ Saunders, L. and Sidel, R. (11 September 2012). *Whistleblower Gets \$104 Million*. **The Wall Street Journal** [online] Available at: <<http://www.wsj.com/articles/SB10000872396390444017504577645412614237708>> (accessed on 14 September 2014)

¹⁰⁶⁷ Lipman, F.D., (2012). *Whistleblowers: Incentives, Disincentives, and Protection Strategies*, John Wiley & Sons

¹⁰⁶⁸ *Ibid.*

The sizes of rewards paid clearly compensate the loss of human capital, end of professional careers, long years of litigation¹⁰⁶⁹ and even imprisonment (as in Birkenfeld case). Notwithstanding the fact that outcome of *qui tam* suits can be very uncertain and significantly delayed in time (5 to 10 years), the expectation of a very big reward might have been an important factor in pursuing the employee to file a case.

However, reluctance of the legislators to employ *qui tam* enforcement in full, including a right of the relators to pursue their case even after rejection by the federal prosecutors, limits a scope of this enforcement tool and at the same time limits the ability of the public to overcome administrative inaptitude or possible regulatory capture. The latter, as some empirical researches show¹⁰⁷⁰, remains one of the concerns among potential relators, who don't want to sacrifice their professional careers only to get stuck by the cosy relationship between government agency and its private contractors.

Qui tam and the effective solutions to the administrative capture it provides will be analysed below in the section "*Qui Tam* vs. Administrative Drift or Capture". The next two sections focus attention on the unique advantages of *qui tam*, which secure it the leading position among other bounty based law enforcement mechanisms, thus providing opportunity to sketch a design of the powerful and cost-effective model of enforcement.

***Qui Tam* and the Optimal Regulatory Design of the Bounty Based Public-Private Model of Enforcement**

¹⁰⁶⁹ Ms Eckard spent eight years defending herself (Lipman (2012), *supra*)

¹⁰⁷⁰ Orsini Broderick (2007), *supra* note 566 at 126; Feldman and Lobel (2010), *supra* note 970 at 220; Dyck *et al.* (2010), *supra* note 13 at 10; Engstrom (2012), *supra* note 441 at 105

In search of the optimal regulatory design of the system, which could combine a well-conceived set of incentives, moral and pecuniary to the extent sufficient to compensate the loss of human capital by a potential whistle-blower, a proper level of protection from retaliation, and an integrated failsafe mode of enforcement to tackle administrative capture, David Engstrom coming from a law and economics perspective proposed a relatively “simple” in his own words theoretical framework capable to provide a methodological basis for both of the two distinctive paths of academic inquiry into effective bounty based enforcement regime¹⁰⁷¹. The first deals with design features in an effort to meet the challenge to optimise the quantity and quality of tips. The other is to consider the complex efficiency/ control tradeoffs that reside in the choice between a simple cash-for-information bounty scheme and an elaborated *qui tam* regime in which whistleblowers are granted a private right of action¹⁰⁷².

That approach first summarised six design dimensions along which pecuniary based regimes differ¹⁰⁷³:

- The bounty amount
- The degree of regulator discretion in determining that amount, and the actor (agency or court) who wields such discretion

¹⁰⁷¹ Engstrom, D.F., *Whither Whistleblowing? Bounty Regimes, Regulatory Context, and the Challenge of Optimal Design*, 15 **Theoretical Inquiries in Law** (2014) 605-633

¹⁰⁷² *Ibid.*, p. 613

¹⁰⁷³ *Ibid.*, p.p. 605-606

- Whether a whistleblower can exercise independent enforcement authority and, if so, the degree to which public regulators exercise residual control over conduct of that authority
- Retaliation protections, including sanctions for retaliatory acts or guaranteed anonymity
- Limitations on whistleblower standing, including carve-outs excluding particular whistleblower types (counsel, organisational outsiders) from participation
- Filing prerequisites, including the requirement that a whistleblower first report wrongdoing internally before making an external report to a regulator.

Then Engstrom builds them into discrete features of the regulatory contexts most often implicated in debates over the optimal design of regimes: a two-by-two grid, designed to distinguish two core features of the regulatory contexts where bounty regimes are already in place – procurement, tax and securities fraud; or that most frequently draw bounty-oriented reform proposals -- environmental protection, workplace safety. One axis of the grid captures the extent to which the harm to be regulated is more or less direct. The other axis captures whether the legal mandate to be implemented is more or less determinate¹⁰⁷⁴.

Whether the harm is more or less direct to the would-be whistle-blower matters to the optimal design of the regulatory regime. First, it is important in terms of the potential standing. Second, the degree to which harm is direct more likely correlates with the level of moral disapprobation the misconduct attracts within a society, thus lowering psychological barriers to report the wrongdoing. It is obvious that on this axis the work place safety and

¹⁰⁷⁴ *Ibid.*, p.p. 620-621

environmental protection signified more direct harm.

Legal determinacy in this framework means whether a legal mandate is comprised mostly of rule-like legal commands or more flexible, standard-like directives, thus affecting the mandate's application. It can be more bounded, or instead open to adaptation to new fact situations or regulatory contexts¹⁰⁷⁵. In terms of legal determinacy, regulatory framework on tax, security fraud and environmental protection is significantly more rigid and specific than the one that deals with procurement fraud and workplace safety.

The degree of legal determinacy matters because it may affect the costs to government of the regulation. The costs may be greater in a less determinate regulatory area than in a more determinate one because the government may end up paying higher bounties in order to generate a productive level of information, or in case of an administrative drift when a successful relator in a *qui tam* lawsuit has been denied support of a regulator. However, greater indeterminacy, by reducing the certainty of payouts, may tend to reduce tip volume¹⁰⁷⁶. The effect of uncertainty on tip volume also depends on whether the uncertainty is symmetric or skewed, and also on the degree of risk aversion of whistleblowers¹⁰⁷⁷.

For Engstrom, legal indeterminacy presents a particular challenge, as correlates with the risk that private enforcers vested with a *qui tam* private right of action may drive the elaboration of legal mandates in democratically unaccountable directions¹⁰⁷⁸. The greater indeterminacy translates into a larger interpretive space within which private actors can maneuver in their

¹⁰⁷⁵ *Ibid.*, p.p. 624-625, citing Kress, K., *Legal Indeterminacy*, 77 **California Law Review** (1989), p. 283

¹⁰⁷⁶ *Op. cit.*, p. 627

¹⁰⁷⁷ Calfee, J.E. and Craswell, R., *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 **Vanderbilt Law Review** (1984), p. 965; Craswell, R. and Calfee, J.E., *Deterrence and Uncertain Legal Standards*, 2 **Journal of Law, Economics & Organization** (1986), p. 279

¹⁰⁷⁸ Engstrom, D.F., *Private Enforcement's Pathways: Lessons from Qui Tam Litigation*, 115 **Columbia Law Review** (2014)

efforts to exploit regulatory ambiguities and drive the elaboration of legal mandates beyond the control of legislative or administrative overseers.

Such concern stems from the FCA's unbounded and sprawling nature. *Qui tam* enforcement efforts as privately driven legal innovation at the regulatory frontier, have drawn regular criticism for colonising other regulatory regimes for which Congress did not provide a private right of action¹⁰⁷⁹. In this respect, the skeptics, including Engstrom, give more favour to the simpler bounty based whistleblower mechanism¹⁰⁸⁰.

Applying Engstrom's Framework to *Qui Tam* Enforcement Mechanism

When model is based on a matrix principle the outcome depends mainly on the weights allocated to its elements. When legal indeterminacy is viewed as a weakness that opens gates to uncontrolled legal innovation, and therefore is given the prevailing weight, the analysis above suggests that regulatory architects to rearrange competing bounty designs more in favour of a simplistic, but harmless to the regulatory edifice cash-for-information regime.

The False Claims Act, with its open-textured, antifraud mandate, is proposed to be downgraded to a simple bounty regime to eliminate concern about privately driven legal

¹⁰⁷⁹ Phelps, L.M., *Calling Off the Bounty Hunters: Discrediting the Use of Alleged Anti-Kickback Violations to Support Civil False Claim Actions*, 51 **Vanderbilt Law Review** (1998), pp. 1003-28 (explaining that the increase in FCA cases has "spawned new theories of liability, many of which stretch the boundaries of the FCA beyond its logical jurisdictional limits")

¹⁰⁸⁰ See Kovacic, W.E., *The Civil False Claims Act as a Deterrent to Participation in Government Procurement Markets*, 6 **Supreme Court Economic Review** (1998) 201-237 (advocating delimiting "categories of conduct that *qui tam* relators can attack" in the FCA context); Stephenson, M.E., *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 **Virginia Law Review** (2005) 93-107 (arguing more generally for agency authority "to create and delimit private rights of action")

innovation, statutory drift, and the FCA's tendency to colonise other regulatory mandates¹⁰⁸¹. By contrast, the current cash-for-information regime applied to more structurally rigid tax and work safety regulations can be upgraded to a more complex and elaborated *qui tam* regime¹⁰⁸².

New York State's recent extension of its FCA to the tax area¹⁰⁸³ ironically proves the same properties of the False Claims Act that attract concern. Given the Tax code's greater legal determinacy compared to the FCA's open-ended antifraud mandate, a *qui tam* mechanism would bring with it some of private enforcement's benefits (private sector efficiencies, a possible anti-capture and gap-filling role), but carry less risk of statutory drift as a result of privately driven legal innovation¹⁰⁸⁴. There is, however, one challenge in applying a *qui tam* regime to the taxation: it assumes a privately driven incursion into the tax shelter, transfer pricing, and other less determinate areas of tax law. Not coincidentally, they belong to the group of the most sensitive to external lobbying areas of legislation. Most likely, such perspective will provoke a legislative initiative to denote these sections as bounty-ineligible.

Workplace safety regulation seems well suited to a bounty approach in general, and a *qui tam* mechanism, in particular¹⁰⁸⁵. Occupational Safety and Health Administration (OSHA) is drastically underfunded and bureaucratically dysfunctional¹⁰⁸⁶, thus leaving the regulated

¹⁰⁸¹ Engstrom, *supra* note 1122 at 629

¹⁰⁸² *Ibid.*

¹⁰⁸³ New York False Claims Act, N.Y. State Fin. Law § 189 (extending state FCA to tax area)

¹⁰⁸⁴ Ventry, D. Jr., *Whistleblowers and Qui Tam for Tax*, 61 **Tax Law** (2008) 357

¹⁰⁸⁵ Shapiro, S. A., *Substantive Reform, Judicial Review, and Agency Resources: OSHA as a Case Study*, 49 **Administrative Law Review** (1997) 645

¹⁰⁸⁶ Bardach, E., and Kagan, R., (1982). *Going by the Book: The Problem of Regulatory Unreasonableness*. Temple University Press (noting that OSHA had had "no positive effect or a very small one on workplace accident rates"); McGarity, Th., and Shapiro, S.A., (1993). *Workers at Risk: The Failed Promise of the Occupational Safety and*

entities with a vanishingly small risk of inspection¹⁰⁸⁷. A well-designed bounty regime may secure a flow of surfacing information about safety violations that the current under-resourced inspection regime does not provide.

There is also a reason to believe that a *qui tam* approach would be preferred. Evidence suggests that OSHA's selection of inspection targets is designed to generate a regularised row of detected violations, to the detriment of low-probability hazards or harms with long latency periods¹⁰⁸⁸. As in the securities fraud area, a *qui tam* mechanism has a potential to play a gap-filling, "failsafe" role, prosecuting workplace violations that would serve the public interest, but do not align with agency's politically-induced enforcement approach¹⁰⁸⁹.

The conclusions Engstrom draws from his analysis, show challenges of the approach, leaning to the concept of grand design in respect of the legislation, with very limited space for innovation. When cost effectiveness and openness to some level of private driven legal innovation with limited government participation becomes a foundational principle, the Engstrom's framework brings about different results.

First of all, it is reasonable to assume that *qui tam* mechanism is the least suitable for application to tax legislation. Among all US legislation the Internal Revenue Code is probably one of the most challenging to embrace *qui tam*. With 9834 sections the voluminous statute

Health Administration, Praeger (offering a similarly sceptical assessment)

¹⁰⁸⁷ Weil, D., *Assessing OSHA Performance: New Evidence from the Construction Industry*, 20 **Journal of Policy Analysis and Management** (2001) 651 (determining a construction site's annual probability of inspection to be 0.039%)

¹⁰⁸⁸ Lobel, O., *Interlocking Regulatory and Industrial Relations: The Governance of Workplace Safety*, 57 **Administrative Law Review** (2005) 1071

¹⁰⁸⁹ Engstrom, *supra* note 1122 at 631

is so large¹⁰⁹⁰, so complicated, that even contains some textual discrepancies between its various editions¹⁰⁹¹. To expand the sprawling nature of *qui tam* to cover IRC will inevitably become an exercise with a constant discovery of unintended consequences. Indeed, the conduct of *qui tam* relators in respect of violation of the IRC has to be meticulously delimited prior to the upgrade of the current bounty regime.

Downgrading the FCA by depriving it from the *qui tam* mechanism will generate significant public costs. A new regime would forfeit the private-sector efficiencies the current *qui tam* structure achieves, particularly the ability of an increasingly sophisticated relator's bar to adjust enforcement capacity as FCA enforcement opportunities ebb and low.

Other potential costs will include a change in capture dynamics as a result of moving to a simple cash-for-information approach. There is a wishful thinking that a plaintiff's bar, including the securities class action bar and also an increasingly sophisticated *qui tam* relator's bar, would quickly move into the Dodd-Frank cash-for-information regime upon its application to the government procurement. The sophistication will not be needed anymore, and such move will bring about an effect of overcrowding among the group of more experienced lawyers. This will lead to the drop in activity of the current relator's bar in respect of the downgraded FCA regime. The weakened bar will be less able to counter capture by pulling "re-alarms" to alert legislators where DOJ was dispensing regulatory favours via its gatekeeper decisions¹⁰⁹².

¹⁰⁹⁰ See, US Code: Title 26 – Internal Revenue Code [online] Available at: <https://www.law.cornell.edu/uscode/text/26>. Accessed on 30 June 2016

¹⁰⁹¹ See, *Tax Analysts v. Internal Revenue Serv.*, 214 F.3d 179 (D.C. Cir. 2000)

¹⁰⁹² McCubbins, M., and Schwartz, Th., *Congressional Oversight Overlooked: Police Patrols Versus Fire Alarms*, 28 *American Journal of Political Science* (1984) 165

Downgrading will inevitably deprive the system of salutary forms of innovation by diminishing the ingenuity the *qui tam* lawyers currently supply in piecing together new and ever more sophisticated frauds that have escaped regulators' attention. Significant number of such lawyers will find themselves overqualified and underpaid in their work to assist whistleblowers in a simple bounty regime.

The argument that much of the value the more and more specialised counsel adds to the current *qui tam* regime comes pre-filing or during efforts to persuade DoJ to join the case, but not in post-filing litigation, will deprive the whole system of the systemic advantage that makes *qui tam* so valuable to society. Next section will give a more detailed analysis to the role of private counsel in *qui tam* mechanism as one of its key advantages as a unique contribution to the crime deterrence and law enforcement.

***Qui Tam* as a Most Effective Mechanism of the Public-Private Enforcement Model**

Viewed through the efficiency lens, the choice of the enforcement turns at least in part on an empirical judgment as to which can generate a chosen level of enforcement effort — and, with it, a desired quantum of deterrence — at lower social cost. As was shown in previous sections, a public-private enforcement model has in theory the potential to achieve the most pervasive enforcement at the lower social cost. By relying on hidden information about breach of law, which is in the possession of whistleblowers, the government agencies acting in an environment of information asymmetry avoid costly investigations. To overcome fear of retaliation and almost inevitable loss of human capital by the potential whistleblowers the

poorly informed government enacts specific legislation with the express purpose of inducing parties with private information about socially costly dishonest or illegal behaviour to come forward.

There are, however, some constraints that limit application of this enforcement design. First, an agency problem, when a government body shows inaptitude in prosecuting potential fraud due to administrative capture. Second, a government has to sift through evidence to screen out the poor information brought in by the whistleblowers. The government seeks a mechanism that encourages whistleblowers with high-quality information to come forward, but at the same time, discourages whistleblowers with low-quality information from relation. Investigations of claims made by low-quality informants are a waste of society's resources. Third, a government seeks to discourage frivolous suits, which exhaust judicial branch incurring socially inefficient costs. Fourth, there have to be a right balance between potential costs of relation, and level of reward to prevent crowding out valuable information.

The analysis rendered above has been provided with an assumption that a *qui tam* mechanism is uniquely positioned to offer the most efficient solution to the identified constraints. To prove this assumption a simple model has been developed that captures the essence of the ***qui tam* optimisation function**. Built up upon the Kwok's modeling discussed above¹⁰⁹³, and game theory¹⁰⁹⁴, it is based on two foundational assumptions.

First, it is assumed that the anti-fraud statutes have dominant punitive goal as well as

¹⁰⁹³ See Section "Modelling a *Qui Tam* Mechanism within Regulatory Enforcement Policy" this Chapter at 208-218

¹⁰⁹⁴ Casey and Niblett, *supra* note 978 at 1169-1217; Watson, J., (2008). *Strategy: An Introduction to Game Theory*. 3d ed., Wiley; Rasmusen, E., (2006). *Games and Information: An Introduction to Game Theory*. 4th ed., Wiley-Blackwell; Christen, M., *Information Acquisition by Firms: The Role of Specialisation, Motivation and Ability*. Working Paper n98/77/MKT, INSEAD (1998) [online] Available at <https://sites.insead.edu/facultyresearch/research/doc.cfm?did=46503> Assessed on 2 September 2016

deterrence. Other theories of punishment may focus on factors such as the expressive power of law to make certain rules more salient, provide behavioural focal points, or to otherwise shift norms¹⁰⁹⁵. But this model is consistent with the legislative history surrounding *qui tam* legislation¹⁰⁹⁶.

Second, the same soft rational actor framework is applied as elsewhere in this research. The impact of imposing costs and offering rewards will obviously differ if whistleblowers or those committing fraud are not rational or act out of derangement. The model therefore accounts for non-pecuniary costs and rewards. A whistleblower may get value from morality, indignation, or revenge. As with any other payoff that value must be considered when designing the correct cost-reward dynamic.

In the model, an employee receives private information about whether their firm has committed fraud. The individual receives a signal that is either strong or weak. The strong signal of fraud provides for corporate documents or other bulletproof evidence (like tape recordings) that outlines how the company has defrauded the government. The weak signal of fraud does not provide for any direct evidence that company has been engaged in dishonest or fraudulent dealings. Such weak signals may be in a possession of a relatively high number of employees, and often appear in the form of a rumour. The model assumes that the weak signal is correct only ten percent of the time, and that an employee knows the quality of the information, whether the information is strong or weak, and knows the probability of the claim to be successfully proven. As it was discussed above¹⁰⁹⁷, before

¹⁰⁹⁵ McAdams, R.H., *A Focal Point Theory of Expressive Law*, 86 *Virginia Law Review* (2000) 1649

¹⁰⁹⁶ See Chapter I

¹⁰⁹⁷ See *supra* at 232-236

submitting a claim a potential whistleblower/ relator most likely would seek a professional advice from a counsel to assess the probability of success.

For the purposes of this model it is assumed that the government agency/ regulator is not captured and would harness the employee's inside information about fraud to overcome its information deficiencies. There are two challenges that the government must address in case it chooses to incentivise whistle-blowing behaviour. First, the government agency cannot *ex ante* assess the quality of the information that is brought by the whistleblower. In order to determine whether the signal of fraud is strong or weak, the government must launch a full-scale investigation at a cost of \$1 million¹⁰⁹⁸.

Second, there is a private cost that potential relators must bear when submitting their claim. These costs include potential retaliation by the employer, and more importantly a real perspective of a loss of accrued human capital. It is reasonable to assume that the whistleblower estimates these costs to be \$500,000.

There are two ways for the government to improve the benefit-cost balance. One way is to minimise the cost of claim by ensuring confidentiality and anti-retaliation protection. Which, as was discussed above, did not prove to be an unequivocal success¹⁰⁹⁹.

Another method is to increase the benefit side of the equation by compensating the whistleblowers for any losses they may incur by providing the information. Consistent with the analysis provided by this work¹¹⁰⁰, the potential whistleblower expects to receive at least

¹⁰⁹⁸ On costs of investigations and their effect on rewards see: Casey and Niblett, *supra* note 978 at 1193-1197; Farhang (2010), *supra* note 492 at 119

¹⁰⁹⁹ See section "Economic Analysis of *Qui Tam* Relators Behaviour" of this Chapter at 228-248

¹¹⁰⁰ *Ibid.*

\$500,000 in compensation to come forward¹¹⁰¹.

When the investigative authority recognises the necessity to financially incentivise the potential whistleblowers, it has a choice of different institutional options so far available.

First comes a flat fee, or fixed payment, made to everyone who brings the information. If the government agency offers \$500,000 to all potential whistleblowers, then everyone with weak and strong signal will come forward. As a result of this incentive scheme, the government will be overburdened by the claims, unable to identify the valuable tips from the noise. This will generate a so-called pooling effect, when every informant receives the same treatment. The flat fee therefore fails to separate strong information from weak. Consequently, the government agency drowned in a flood of tips will not have sufficient resources to investigate them all thus diluting resources allocated to the promising cases. It leads to under enforcement, and from law and economics perspective, reduces deterrence. As shown in academic literature on the subject, the deterrent effect of law is reduced as the likelihood of inaccuracy in the legal system¹¹⁰². The fraudulent firms are less likely to be found guilty of fraud when the regulator must randomise which firms to investigate because it has received too many tips. Given that they are less likely to be found guilty, the likelihood of committing fraud increases; this is in spite of the increase in the quantity of information flowing to the

¹¹⁰¹ The size of compensation is calculated on a basis of US Bureau of Labor Statistics data on median income of white-collar employees (Sourced from [payscale.com](http://www.payscale.com) [online] Available at http://www.payscale.com/research/US/Job=Office_Administrator/Hourly_Rate. Accessed on 30 October 2016). In case of potential whistle-blowers employed by the biggest multinational corporations, the expected compensation will be significantly higher. The same methodology applies to the estimated damages due to be recovered, *infra* at 273

¹¹⁰² Kaplow, L. and Shavell, S., *Accuracy in the Determination of Liability*, 37 **The Journal of Law and Economics** 1 (1994) 1-15; Kaplow, L. and Shavell, S., *Accuracy in the Assessment of Damages*, 39 **The Journal of Law and Economics** (1996) 191; Kaplow, L., *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 **Journal of Legal Studies** (1994) 307

regulator. The fixed payment fee scheme does not work.

Second comes the existing option to make the payment to the informant conditional upon a successful finding of fraud. Both *qui tam* legislation and a simple bounty system provide that a whistleblower is entitled to a portion of the damages that the government receives. Making payment conditional can operate as a screen to incentivise informants with high-quality information, and discourage those in a possession of a less valuable one, because their chances to win remedial proceeds are significantly lower. The expected benefit is a function of the likelihood of success, and individuals with strong information, therefore, have a higher expected reward than individuals with weak information. This generates a so-called separating equilibrium, a point where behaviour of individuals, which belong to different types, becomes distinctly different¹¹⁰³.

The separating equilibrium is to be set at the level sufficient to meet the demands of the potential whistleblowers. If the contingent payment is too low, then there will be a pooling equilibrium, at which no individuals will come forward, and therefore, no deterrent effect. Assuming the expected damages of a company-perpetrator at \$40,000,000, if, for example, the government sets the whistleblower reward at just one percent of any remedial damages neither informants will come forward. Whistleblowers with strong information bear a cost of \$500,000, but have an expected benefit of \$400,000 (one percent of \$40 million) -- not sufficiently high to incentivise risk taking. The expected reward for whistleblowers with weak information is even lower: in the model they have a 10 per cent chance of success, and \$40,000 as a reward does not sound anywhere near attractive.

¹¹⁰³ Watson (2008), *supra* note 1145 at 282-292

The increase of the reward will bring sought-for separating equilibrium, under which only an informant with strong information will submit a claim. Suppose that the government offers ten percent of any damages to the whistleblower. Whistleblowers with strong information have an expected reward of \$4 million. This more than covers the cost of risk taking, as the expected benefits now outweigh the costs. At the same time informants with weak information will not be induced to come forward. With a ten percent chance of recovery, their potential reward in case fraud claim is successful will bring them only \$400,000 – not enough to outweigh their expected personal loss. Under the conditions of the model, only employees with strong evidence will dare coming forward. Since only informants with high-quality information provide tips, the government can focus its efforts on these claims of fraud. This increases the likelihood of fraud detection, and therefore the deterrence, both aspiring goals of the government.

The relationship between increasing rewards and increasing deterrence is not monotonic. If the rewards are too high, then more whistleblowers with weak signals will be incentivised to come forward in the hope of hitting the jackpot. Once again, this will lead to the pooling equilibrium; but this time, too many informants come forward¹¹⁰⁴. If the success-contingent payment to the potential informants is too high, then the institutional structure begins to resemble the fixed-fee system described above. For example, if a whistleblower is entitled to fifty per cent of the damages awarded against the fraudulent firm then a great number of employees, who receive a signal—weak or strong—will rise to file claims. Whistleblowers with weak information will come forward because the expected reward (10 per cent of 50 per

¹¹⁰⁴ Casey and Niblett, *supra* note 978 at 1196; Ferziger, M.J. and Currell, D.G., *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, **University of Illinois Law Review** (1999), p. 1172

cent of \$40 million) far exceeds the potential costs. As with the flat-fee incentive structure, the government cannot *ex ante* distinguish between well-informed whistleblowers and poorly informed whistleblowers. The regulator is faced with the problem of information overload¹¹⁰⁵. The model shows that excessive contingent payments dilute the quality of the information and have an ancillary effect of reducing the deterrence. Under conditions of the model, increasing the rewards leads to a rather perverse effect of under deterrence¹¹⁰⁶.

Despite the obvious – that a real world is not over simplistic and binary as models assumes – the developed model seems to confirm the factual development that happens in the real world. Even before the Dodd-Frank Act was enacted, the SEC was receiving a high number of tips from the whistleblowers. As a former head of the Texas Securities Commission acknowledged, the problem the SEC had to deal with was not the lack of people eager to file complaints. The Commission received about 750 thousands complaints a year¹¹⁰⁷, but it was not capable to make “good determinations with regard to those complaints that really needed to be followed up on”¹¹⁰⁸. The theory that suggests the encouraging whistleblowing through a simple pecuniary incentive mechanism will therefore be counter-productive in

¹¹⁰⁵ Casey and Niblett, *supra* note 978 at 1197

¹¹⁰⁶ In terms of formulas, the model stays as follows: The remedial damages are D , the percentage awarded to the whistleblower is r , and the cost of submitting a claim is c . The probability of victory in a claim is p and is known by the whistleblower. A whistleblower will be incentivised to come forward, if $r > c/pD$. The informants with weak information have a probability of victory as p_w , those with strong information -- p_s . The threshold percentage of damages required to encourage strong informants is $S=c/p_sD$. The threshold percentage of damages where weak informants will also be encouraged is $W = c/p_wD$. It follows that $W > S$ (After Casey and Niblett, *supra* note 978 at 1197)

¹¹⁰⁷ Denise Crowford in testimony before the Committee on Financial Services of the US House of Representatives. *Capital Markets Regulatory Reform: Strengthening Invest Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 84 (2009), [online] Available at <http://financialservices.house.gov/media/file/hearings/111/printed%20hearings/111-84.pdf> Accessed on 15 October 2016

¹¹⁰⁸ *Ibid.*

detering fraud is corroborated by robust evidence from the regulatory practice.

However, when a described above model applied to the *qui tam* mechanism the result comes up with an equilibrium that allows the government to achieve its goals in the most efficient way.

Qui tam actions bring a set of specific costs, which act as safeguards to hinder efforts of those who do not possess the valuable information in respect of fraud. In a business world, where material factor plays one of the most important roles in decision-making, the screening effect of these costs brings about opportunities over simple whistleblowing procedure.

First, there are notable costs of bringing suit in court, and these costs must be added to the looming costs of human capital loss and career failure. The litigation costs are not relevant for the whistleblowers providing tips to the government agencies, but only incurred by *qui tam* relators. First of all, there are significant upfront costs of hiring attorneys, filing costs, and substantiating claims. The relators turned plaintiffs will need to expend resources to convince the lawyers that their information provides strong evidence of the breach of law. The procedure is lengthy, and the plaintiffs must prove to the judge that they have cleared a number of statutory hurdles. Additionally, as with any lawsuit, the plaintiff must meet minimum pleading requirements, the barrier that most likely will deter potential plaintiffs with weak evidence from filing suit¹¹⁰⁹. It means that at a very initial stage the *qui tam* procedure filters the incoming information screening out the weak relators.

Second, the costs borne by *qui tam* relators hit disproportionately those who bring weak

¹¹⁰⁹ Law and economics theory produced a significant body of research on the decision-making to file suit. See, Posner, R., (2014). *Economic Analysis of Law*. 9th ed., Walters Kluwer Law & Business, (Chapter 22, Civil and Criminal Procedure), pp. 606-651

cases with low probability to succeed. False Claims Act stipulates that cost shifting is possible, and the court can award costs to the successful side¹¹¹⁰. But this provision is applicable only if relators win. The relator, who aims to bring a frivolous suit, has to keep such costs as a contingency loss.

Qui tam procedure provides that the Department of Justice has to investigate claims made by the whistleblower, and elects whether or not to join the case as a co-plaintiff. This imposes additional costs on a relator: one that is fixed, and other that depends on the quality of the information.

The fixed costs comprise the costs of convincing the Department that the case is strong. Assuming there is no administrative capture and adverse political influence, the DoJ will typically join a strong case, and will reject a weak one. As it has been shown in this work¹¹¹¹, it takes time -- up to several years -- for the Department of Justice to come up with its decision on the information brought by the relator. The costs incurred to demonstrate the strength of the case are likely to be wasted, if the relator knows that the evidence is insufficient. This is analogous to the costs of convincing the contingent-fee lawyer, and convincing the judge at the motion-to-dismiss stage¹¹¹².

As an additional cost that is contingent on the strength of the evidence, when the government joins the suit the remaining costs of suit are borne by the government, but in cases where the government steps aside, the *qui tam* relator must bear the litigation costs. This has the effect of further encouraging relators with strong evidence, and while raising barrier to those, who

¹¹¹⁰ Casey and Niblett, *supra* note 978 at 1204

¹¹¹¹ See sections “*Qui Tam* and Information Symmetry” and “*Qui Tam vs. Administrative Drift or Capture*” of this Chapter

¹¹¹² Casey and Niblett, *op. cit.*

cannot build the convincing case.

Whether the federal government is a very good judge of the strength of a case following a preliminary investigation, or it is a better litigator, the data shows that when the Department of Justice joins a relator in suit, the plaintiff wins in a majority of cases; however, the relator will have some chance to win, when the DOJ refuses to intervene, though with much lower probability¹¹¹³.

Third, the relator's lawyers work as additional investigators of the evidence that is brought forward. The complexity and cost of prosecuting a *qui tam* case require specialisation, and therefore will more likely involve an experienced counsel to take the case. As it was shown, the lawyers in *qui tam* cases add value¹¹¹⁴, and their involvement release the limited resources to be channeled by the government to investigate fraud elsewhere.

The *qui tam* mechanism is effective precisely because a court-centric system disproportionately places the burden for losses on plaintiffs with poor information. The model predicts that courts in *qui tam* litigation are not likely inundated with poor cases. As the model shows, the *qui tam* mechanism optimises the process of enforcement within public-private model by introducing three screening barriers, which sift out the evidence to be litigated on behalf of the government to discard the weak signals and educe the promising ones: (1) the private lawyer screen; (2) the court screen on a stage of a motion to dismiss; (3) the Department of Justice screen, when making its decision to proceed¹¹¹⁵. At each point, the relator undertakes costs that are likely to be wasted if the obtained information is weak. *Qui*

¹¹¹³ See Sections “Analysing *Qui Tam* in the Context of Public vs. Private Enforcement” and “Modelling a *Qui Tam* Mechanism within Regulatory Enforcement Policy” of this Chapter

¹¹¹⁴ Engstrom, *supra* note 1174 at 1251-1252

¹¹¹⁵ In more depth the screening function of *qui tam* is analysed in Casey and Niblett, *supra* note 978

tam action, therefore, provide a key institutional advantage over whistleblowers reporting directly to a regulator. Litigation forces relators to bear an upfront cost. Further, the costs of litigation are greater as the probability of winning falls. This discourages relators who know they have poor information from coming forward, thereby discouraging overzealous, non-meritorious or frivolous claims.

***Qui Tam* vs. Administrative Drift or Capture**

The foregoing account of private enforcement regimes as an effective form of policy intervention is contested by some researchers. A contending line of arguments doubts whether the *qui tam* mechanism can advance statutory policy goals, and advances core arguments that *qui tam* relators lead to explosion of frivolous suits; empower judges, who lack policy expertise, to make policy; weaken the administrative state's capacity to articulate a coherent regulatory scheme by pre-empting administrative rulemaking; usurp prosecutorial discretion; and, finally, discourage cooperation with regulators and voluntary compliance¹¹¹⁶.

A primary justification for delegation of policy implementation authority to bureaucracy is to leverage the expertise — informational resources, analytical competence, regulatory

¹¹¹⁶ Blomquist (1988), *supra* note 435 at 106; Stewart and Sunstein, *supra* note 590 at 130, pp. 1292–1293; Zinn, M.D., *Policing Environmental Regulatory Enforcement: Cooperation, Capture, and Citizen Suits*, 21 **Stanford Environmental Law Journal** 81 (2002), p. 84; Grundfest, J.A., *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 **Harvard Law Review** 961 (1994), pp. 970–71; Kagan, R.A., *Adversarial Legalism: Tamed or Still Wild?*, 2 **New York University Journal of Legislation and Public Policy** 217 (1999); Stephenson, M.C., *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies* 91 **Virginia Law Review** 93 (2005), p. 116; Pierce, R.J., Jr., *Agency Authority to Define the Scope of Private Rights of Action*, 48 **Administrative Law Review** 1 (1996); Cross, F.B., *Rethinking Environmental Citizen Suits*, 8 **Temple Environmental Law & Technology Journal** 55 (1989), p.69; Austin, J.L., *The Rise of Citizen-Suit Enforcement in Environmental Law: Reconciling Private and Public Attorneys General*, 81 **Northwestern University Law Review** 220 (1987); Spence, D.B. and Cross, F., *A Public Choice Case for the Administrative State*, 89 **Georgia Law Review** 97 (2000); Bawn, K., *Political Control Versus Expertise: Congressional Choices About Administrative Procedures*, 89 **American Political Science Review** 62 (1995); Greve (1990), *supra* note 461 at 107

experience — of policymakers within an administrative body¹¹¹⁷. As compared to a more centralised, unified, and integrated administrative scheme orchestrated by an administrator at the top of a hierarchical agency with powers of national scope, when a large role is given to private enforcers in implementation, resulting policy will tend to be confused, inconsistent, and even straightforwardly contradictory¹¹¹⁸.

The litigation by independent *qui tam* relators bears the risks of creating incoherent fragmented legislation due to the inability of judges to give each case an adequate consideration and their lack of understanding of the larger regulatory scheme¹¹¹⁹. This renders regulatory policy, according to Pierce (1996), via “judicial opinions [that] are massively inconsistent and incoherent.”¹¹²⁰ The lack of prosecutorial discretion, argue others, lead to overzealous enforcement, excessive litigation and loss of necessary flexibility of the law enforcement policy¹¹²¹.

On macro-level, some researches view *qui tam* enforcement as a threat to public control over the elaboration of legal mandates, which brings the risk that private enforcers vested with a *qui tam* private right of action will drive the elaboration of legal mandates in democratically unaccountable directions¹¹²². More specifically, they are concerned that entrepreneurial *qui tam* enforcers will relentlessly press law’s boundaries, exploiting regulatory ambiguities in

¹¹¹⁷ Bawn (1995), *supra*, p.62

¹¹¹⁸ Burbank, S.B., Farhang, S. and Kritzer, H.M., *Private Enforcement*, 17 **Lewis & Clark Law Review** 637 (2013), p.667

¹¹¹⁹ Grundfest (1994), *supra*, pp. 969-971

¹¹²⁰ Pierce (1996), *supra*, pp. 8-9

¹¹²¹ Harkins, M.J., *The Ubiquitous False Claims Act: The Incongruous Relationship Between a Civil War Era Fraud Statute and the Modern Administrative State*, 1 **Saint Louis University Journal of Health Law & Policy** 131-174 (2007-2008); Beck (2000), *supra* note 4 at 5; Stephenson (2005), *supra* note 949 at 215

¹¹²² Shavell, S., *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 **The Journal of Legal Studies** (1997) 575

industry-wide lawsuits, rather than targeting patently illegal wrongdoing that public-minded prosecutors would reject¹¹²³. And because judiciary, agencies, and even the legislature itself, due the limited will and capacity of courts, can only imperfectly police these efforts, *qui tam* regimes may, relative to cash-for-information regimes, exhibit substantial statutory “drift” away from legislative purposes over time.

A growing number of litigation outcomes this theory assumes, can reshape the interest-group environment by giving early litigation losers powerful incentives to work politically to ensure that their competitors are subject to the same liability¹¹²⁴. The result is what political scientists and economists would call an increasing returns process in which early litigation outcomes, by incrementally remaking the political landscape, can push legal mandates along evolutionary paths that are different from those the law would follow in the absence of a private enforcement role. The presence of a *qui tam* mechanism can thus drive the law down pathways it would not travel when enforcement was left in purely public hands.

In its core, this advocacy of prosecutorial discretion and the strict view of power delegation is based on the belief, that the end and purpose of most of the actions of politicians and legislators in making choices for society is the greater good of society or the “public interest” – in other words, that the government “is run for the benefit of all the people”¹¹²⁵. From the broader methodological perspective, this belief forms the view -- implicit in neoclassical

¹¹²³ See Engstrom, D.F., *Private Enforcement’s Pathways: Lessons from Qui Tam Litigation*, 115 **Columbia Law Review** (2014)

¹¹²⁴ As Engstrom speculates, had Walmart, contrary to reality, suffered a large judgment in *Walmart v. Dukes*, 131 S. Ct. 2541 (2011), the company would have faced powerful incentives to make sure that its big-box-store competitors were similarly subject to large-scale class actions asserting discrimination via excessive managerial discretion. *Walmart*, 131 S. Ct. 2541. See, Engstrom, D.F., *Whither Whistleblowing? Bounty Regimes, Regulatory Context, and the Challenge of Optimal Design*, 15 **Theoretical Inquiries in Law** (2014), p. 619

¹¹²⁵ Farber, D. and Frickey, P., *The Independence of Public Choice*, 65 **Texas Law Review** 873-927 (1987), p. 873

model underlying the mainstream law and economics -- that the government's role is to correct market failure.¹¹²⁶

Its roots stretch to the Progressive Era, which gave rise to the theory of "public interest" postulating that the problems of "market failures" to be dealt through regulation, adopted by the government. Regulation operated to cure market failures by substituting the expert planning decisions of an administrative agency for the defective allocations of the failed market. Up to the 1950s it was thought that regulators "generally did a creditable, if flawed job"¹¹²⁷. However, from the mid-1950s through the 1960's and 1970's, as scholars examined the record of regulated industries, they found that regulation did not work perfectly well. It was not only the imperfectness in the sense of what had been viewed by Ronald Coase as second tier externalities borne to life by the regulation aimed at curing the externalities produced by an unregulated market¹¹²⁸. It was the protection of entrenched interests, corporate or geographic, from any change at all costs, and the vested interests that hid behind regulatory rulings that shook the established view. The evolution of the regulatory process turned out to be in the direction to what was passionately opposed by the leading figures of the progressive movement on the cusp of the XIX-XX centuries¹¹²⁹.

¹¹²⁶ Mackaay, E., "History of Law and Economics," in Bouckaert, B. and De Geest, G. (eds.), (1999), *Encyclopedia of Law and Economics*. Edward Edgar, Aldershot, p.p. 86-87

¹¹²⁷ Becker, G., "A theory of competition among pressure groups for political for political influence", 98 **Quarterly Journal of Economics** 3 (1983) 311-400, p. 375

¹¹²⁸ Coase, R.H., *The Problem of Social Cost*, 3 **Journal of Law and Economics** (1960), pp. 25-27; As Becker notes, the researches found "prices, which were too high or too low, distorted allocations, mercantile protection, suppression of innovation, extension of regulation beyond the bounds of any known market failure" (Becker, *op. cit.*, p. 377)

¹¹²⁹ Historian Charles Austin Beard, the author of *An Economic Interpretation of the Constitution of the United States* (1913) [online] Available at: <http://thenewschoolhistory.org/wp-content/uploads/2014/07/Beard_An_Economic_Interpretation_of_the_Consti.pdf> Accessed on 18 June 2016; Philosopher John Dewey, the author of *The Public and its Problems*, (1927). Holt, New York; Sociologist

In the face of the discoveries tarnishing reputation of bureaucracy, the public interest theory did not survive as a consensus view on the power delegation effectiveness. The scholarly view of the regulatory process changed from one of control of private behaviour for the public benefit to one of use of governmental powers for private or sectional gain¹¹³⁰. The public interest theory ceded ground to the synthesis of the theories of political and economic decision-making, or public choice theory¹¹³¹.

The proponents of public choice theory offer different perspective within law and economics¹¹³². They question the underlying assumption that actors presumed selfish in private dealings would behave selflessly upon assuming public office. Public choice proposes a private view of politics, a world in which actors in political roles act to maximise something of direct interest to them, but defined in ways particular to their roles: politicians are assumed to maximise their chances of re-election; bureaucrats -- the size and mandate of their bureau; voters -- the benefits they draw from government programmes; interest groups -- the programmes conferring benefits upon their members¹¹³³.

Albion Small, the author of *Between Eras: From Capitalism to Democracy* (1913). The Intercollegiate Press, Kansas City; Economist Thorstein Veblen, the author *The Theory of the Leisure Class: An Economic Study of Institutions* (1973), Houghton Mifflin, Boston

¹¹³⁰ Igiehon, M. O., *Law, Economics, Public Interest and the Theory of Regulatory Capture*. 8 **Mountbatten Journal of Legal Studies** 2 (2004) 2-19, p. 11

¹¹³¹ Buchanan, J.M., and Tullock, G. (1962). *The Calculus of Consent: Logical Foundations of Constitutional Democracy*. University of Michigan Press, Ann Arbor [online] Available at: < <http://www.econlib.org/library/Buchanan/buchCv3.html> > Accessed on 18 June 2016

¹¹³² Arrow, Kenneth J. (1963). *Social Choice and Individual Values*. 2^d ed. Wiley, New York; Black, D. (1987). *The Theory of Committees and Elections*. Kluwer, Boston; Downs, A., (1957). *An Economic Theory of Democracy*. Harper, New York; Niskanen, W.A. (1971). *Bureaucracy and Representative Government*. Aldine, Atherton, Chicago; Olson, M., (1965). *The Logic of Collective Action: Public Goods and the Theory of Groups*. Harvard University Press, Cambridge; Riker, W.H. (1962). *The Theory of Political Coalitions*. Yale University Press, New Haven

¹¹³³ Mackaay (1999), *supra* note 1177, p. 88

The regulatory capture or administrative drift is a key logical component of the theory. Though the regulatory capture as a term can be directly attributable to Marver Bernstein¹¹³⁴, the naissance of the theory could be traced further back to Toulmin Smith, who in his 1849 work¹¹³⁵ wrote a scholarly denunciation of Crown Commissions, a trend prevalent in the XIX century United Kingdom, and many other practices of government that he saw as designed not for the public good or interest, but for vested interests. He characterised the Crown Commissions as playing no other role, but an avenue for the executive to achieve purposes and interests personal to them and their friends¹¹³⁶.

The structure of the UK and US governments, and the way they function have significantly changed since the time of Toulmin Smith, but the notable body of evidence have been collected by the scholars showing the trend that the government agencies are tend to develop a narrow view of the public interest¹¹³⁷. From the point of view of the effective enforcement regime, the distinct set of concerns about misaligned agency incentives cannot be ignored. The main concern is that agencies will be excessively reluctant to authorise private enforcement, because agencies are either “captured” or otherwise unduly influenced by the industries they are supposed to regulate¹¹³⁸, or perhaps simply because each agency jealously

¹¹³⁴ Bernstein, M., (1955). *Regulating Business by Independent Commission*. Princeton University Press, Princeton

¹¹³⁵ Smith, T. J., (1849). *Government by Commissions Illegal and Pernicious*. S. Sweet, London

¹¹³⁶ *Ibid.*, p.16

¹¹³⁷ Mueller, D.C., (2003). *Public Choice III*. Cambridge University Press, Cambridge; Rowley, Ch.K., and Schneider, F., eds. (2004). *The Encyclopedia of Public Choice*. 2 vols. Kluwer, Boston; Shughart, W.F.II and Razzolini, L., eds. (2001). *The Elgar Companion to Public Choice*. Edward Elgar, Northampton, Mass

¹¹³⁸ Farber, D.A., *Positive Theory as Normative Critique*, 68 **Southern California Law Review** 1565 (1995); Peltzman, S., *Toward a More General Theory of Regulation*, 19 **Journal of Law & Economics** 211 (1976); Stigler, G.J., *The Theory of Economic Regulation*, 2 **The Bell Journal of Economics and Management Science** 3 (1971). While capture theory suggests that interest group influence on policy is generally undesirable, other perspectives are more sanguine about the role of pressure groups in shaping regulatory policy: Becker, G.S., *A Theory of Competition Among Pressure Groups for Political Influence*, 98 **The Quarterly Journal of Economics**

guards its enforcement prerogatives and dislikes the idea of anyone else, including private plaintiffs, intruding on its turf¹¹³⁹. Some scholars contend that deputising *qui tam* relators to police fraud on the government is the only way to combat “cosy relationships” between government agencies and industry¹¹⁴⁰. It is the *qui tam* enforcement regime, which offers adequate incentives for enforcement, has the potential to produce durable and consistent enforcement pressure, and avoid influences that may lead an agency to stray from legislators’ enforcement preferences.

In contrast, regulators may choose to under-enforce for a number of reasons. Given that intense preferences for under enforcement exist in the regulated entities, while preferences for enforcement are far more diffuse, the regulated entities have incentives and opportunities to use lobbying, campaign contributions, and other means to seek to influence or capture an agency so as to discourage enforcement¹¹⁴¹.

Regulators themselves may have preferences for under enforcement for many reasons, including ideological preferences, career goals, to protect or enhance budget allocations, to avoid political controversy, or even simple laziness¹¹⁴². Finally, administrators may face

371 (1983). Elhauge contends that interest group influence cannot be evaluated normatively without reference to some other normative goal, and thus it is incorrect to assume that interest group influence is per se an evil that must be “corrected.” (Elhauge, E., *Does Interest Group Theory Justify More Intrusive Judicial Review?* 101 **Yale Law Journal** 31 (1991))

¹¹³⁹ Boyer, B. and Meidinger, E., *Privatizing Regulatory Enforcement: A Preliminary Assessment of Citizen Suits Under Federal Environmental Laws*, 34 **Buffalo Law Review** 833 (1985), p. 841 (agencies sometimes “may resist private enforcement in the belief that the plaintiff groups are intruding on bureaucratic turf or interfering with established policies”); Thagard, E.R., *The Rule that Clean Water Act Civil Penalties Must Go to the Treasury and How To Avoid It*, 16 **Harvard Environmental Law Review** 507 (1992) (asserting that Department of Justice officials view vigorous citizen enforcement of the Clean Water Act as an intrusion on their turf)

¹¹⁴⁰ Schooner (2010), *supra* note 476 at 108

¹¹⁴¹ Gordon, S.C. and Hafer, C., *Flexing Muscle: Corporate Political Expenditures as Signals to the Bureaucracy*, 99 **American Political Science Review** 245 (2005); Merrill, Th. W., *Capture Theory and the Courts: 1967-1983*, 72 **Chicago-Kent Law Review** 1039 (1997); Stewart and Sunstein, *supra* note 590 at 130, p.1294

¹¹⁴² DeShazo, J.R. and Freeman, J., *The Congressional Competition to Control Delegated Power*, 81 **Texas Law Review** 1443 (2003); McCubbins, M.D. et al., *Administrative Procedures as Instruments of Political Control*, 3

pressure to under enforce from executives or legislatures who may be motivated by ideological preferences, electoral imperatives in general, or the desire to protect specific constituents in particular¹¹⁴³.

To be sure, weakness in terms of empirical evidence of administrative capture as a broad phenomenon has long been a subject of academic criticism. Already in 1974 Posner observed that “empirical research [on capture] has not been systematic.”¹¹⁴⁴ As late as 2006, Dal Bó pointed out that “empirical evidence on the causes and consequences of regulatory capture is scarce.”¹¹⁴⁵ However, a more detailed picture of the phenomenon is beginning to emerge, and the latest empirical work is revealing a portrait far more nuanced than the stark black and white sketches of Toulmin Smith, and even more convincing¹¹⁴⁶. Capture is neither

Journal of Law, Economics and Organization 243 (1987); Roach and Trebilcock (1996), *supra* note 923 at 209, p. 482

¹¹⁴³ DeShazo and Freeman, *supra*, p.1454; Faith, R.L. et al., *Antitrust Pork Barrel*, 25 **Journal of Law & Economics** 329 (1982)

¹¹⁴⁴ Posner, R.A., *Theories of Economic Regulation*, 5 **Bell Journal of Economics and Management Science** 2 (Autumn 1974), p. 353

¹¹⁴⁵ Dal Bó, E., *Regulatory Capture: A Review*, 22 **Oxford Review of Economic Policy** 2 (2006), p. 220

¹¹⁴⁶ General discussion: Carpenter, D. and Moss, D. (eds.) (2013). *Preventing Regulatory Capture: Special Interest Influence and How to Limit It*. Cambridge University Press; Moss, D. and Oey, M., “The Paranoid Style in the Study of American Politics,” in Balleisen, E. and Moss, D., eds., (2010). *Government and Markets: Toward a New Theory of Regulation*, Cambridge University Press, Cambridge; Carpenter, D., “Reputation, Information and Confidence – The Political Economy of Pharmaceutical Regulation”, in Farber, D. and O’Connell, A. J., eds., (2009). *Public Choice and Public Law*. Edward Elgar, Northampton, MA; Carpenter, D., *Protection without Capture: Product Approval by a Politically Responsive, Learning Regulator*, 98 **American Political Science Review** 2 (2004) 513–31; Laffont J-J. and Tirole, J., *The Politics of Government Decision-Making: A Theory of Regulatory Capture*, 106 **The Quarterly Journal of Economics** (1991) 1089; Ayres, I. and Braithwaite, J., *Tripartism: Regulatory Capture and Empowerment*, 16 **Law & Social Inquiry** (1991) 435; Levine, M.E. and Forrence, J.L., *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 **Journal of Law, Economics & Organization**, Special Issue, (1990) 167; Michael A. Livermore, M.A. and Revesz, R.L., *Regulatory Review, Capture, and Agency Inaction*, 101 **Georgetown Law Journal** (2013) 1337; A game-theoretic model applied to “approval regulation” contexts such as licensing and permitting, or the review of new drugs and medical devices at the FDA: Carpenter, D. and Ting, M.M., *Regulatory Errors with Endogenous Agendas*, 51 **American Journal of Political Science** 4 (October 2007) 835–53; Division of power and authority: Laffont, J-J. and Martimort, D., *Separation of Regulators against Collusive Behavior*, 30 **RAND Journal of Economics** 2 (Summer 1999) 233-257; On political control over bureaucracy: Moe, T.M., “The Politics of Structural Choice: Toward a Theory of Public Bureaucracy”, in Williamson, O.E., ed., (1995). *Organization Theory: From Chester Barnard to the Present and*

absolute nor one-dimensional. In some cases, influence over regulators may still be explicitly purchased, but such illegal activity is likely more the exception than the rule in the United States¹¹⁴⁷. Implicit *quid pro quo* is almost certainly more typical, and “industry may find even implicit deals unnecessary when broader influence can be exercised, indirectly, through *cultural capture*”¹¹⁴⁸.

The above said suggests that executive agencies cannot be unequivocally trusted with enforcement. Thus, Upshaw Downs and Swienton (2012)¹¹⁴⁹ showed the limitations on the effectiveness of using *qui tam* mechanism become unavoidable, when the government itself has acquiesced to the company’s wrongdoing. Often when a favoured contractor finds itself in trouble over procurement, the government agency is more interested in hiding the problem than solving it. Scandals in government contractor programmes can create problems for the government’s programme managers. Therefore, if there is any credible discretion, a government agent may hand out waivers or some other form of approval of a company’s misconduct, even though it formally violates the agency’s regulations. Even passive

Beyond. Expanded ed. Oxford University Press, New York; McCubbins, M.D., Noll, R.G. and Weingast, B.R. *Administrative Procedures as Instruments of Political Control*, 3 **Journal of Law, Economics, & Organization** 2 (Autumn 1987) 247; Croley, S.P., (2008). *Regulation and Public Interests: The Possibility of Good Regulatory Government*. Princeton University Press, Princeton; Balla, S. *Administrative Procedures and Political Control of the Bureaucracy*, 92 **American Political Science Review** (1998) 663–73; Consumer empowerment to tackle agency inaptitude: Trumbull, G., (2012). *Strength in Numbers: The Political Power of Weak Interests*. Harvard University Press, Cambridge, MA; Executive review of regulations based on cost-benefit analysis: Sunstein, C., *Empirically Informed Regulation*, 78 **University of Chicago Law Review** (2011) 1349; On growing evidence for a more general association between media coverage and agency behaviour: Carpenter, D., *Groups, the Media, Agency Waiting Costs and FDA Drug Approval*, 46 **American Journal of Political Science** 3 (July 2002) 490–505; Gordon, S., *Politicizing Agency Spending: Lessons from a Bush-Era Scandal*, 105 **American Political Science Review** 4 (November 2011) 717–34; Dyck, A., Moss, D.A. and Zingales, L., *Media versus Special Interests*. NBER Working Paper Series, No. 14360, (September 2008)

¹¹⁴⁷ Casey and Niblett (2014), *supra* note 978

¹¹⁴⁸ Carpenter and Moss (2013), *supra* note 1197 at 452

¹¹⁴⁹ Upshaw Downs, J.C. and Swienton, A.R., ed. (2012). *Ethics in Forensic Science*. Academic Press, Oxford-Waltham

government compliance that winked at fraud can trigger the legal doctrine of “acquiescence”, a common defence that there can’t be fraud if the victim does not care¹¹⁵⁰. The Department of Justice, moreover, rarely tries to prosecute a government agent for giving waivers, and often uses waivers as an excuse not to prosecute the companies. The normal practice is that if a federal government agency opposes a False Claims suit, the Department of Justice will not pursue it. As a practical matter, the Department cannot succeed without the regulatory agency’s expertise and supportive testimony.

The political interference from a higher level, which some scholars view as at least a partial solution¹¹⁵¹, cannot bring the effective resolution. The influence sought to overcome administrative capture comes from politically elected officials above the agency. But in turn, those officials may be captured by special-interest groups, or act from their own electoral perspective. The solutions to the capture problem may be at odds with each other: political oversight might curb regulatory capture at the agency level, but increase potentially problematic political influence. In that sense, as some researches point out, the political oversight just moves the capture problem up one step in the command chain¹¹⁵².

A problem of regulatory capture, and inability of political influence to mitigate it undermines trust that the individuals within executive branch agencies and departments can be trusted with acting on information that their long-time business partners are defrauding the government. More studies point out to the growing evidence that no executive agency can be designed to significantly reduce regulatory capture¹¹⁵³. This assumption has stronger

¹¹⁵⁰ *Ibid.*, p.106

¹¹⁵¹ See, McCubbins *et al.* (1987), Moe (1995), Sunstein (2011), *supra* note 1197

¹¹⁵² Casey and Niblett (2014), *supra* note 978 at 1179

¹¹⁵³ Casey and Niblett, *Ibid.*; Barkow, R.E., *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 **Texas Law Review** (2010) 15; Datla, K. and Revesz, R.L., *Deconstructing Independent Agencies (and Executive*

empirical and theoretical support. While, for example, the SEC's organisation as an independent agency may be explained as an attempt to reduce almost inescapable political influence¹¹⁵⁴, one may identify a regulatory-capture problem that arises from the cosiness that exists between the SEC and the finance industry¹¹⁵⁵.

Various mechanisms and structures that employ internal and external checks on a given agent's bad incentives have been suggested, including dual agencies, independent monitors, court oversight, congressional oversight, and overlapping state power¹¹⁵⁶. To no avail, even oversight by a central agency like Department of Justice and Office of Information and Regulatory Affairs cannot be regarded as a potential curb to some of the agency-capture problems¹¹⁵⁷.

The case in point is the travails of the now defunct Minerals Management Service (MMS) (formerly within an administrative structure of the Department of the Interior), a very influential and powerful agency that regulated federal natural resources and collected

Agencies), 98 **Cornell Law Review** (2013) 769; Vermeule, A., *Conventions of Agency Independence*, 113 **Columbia Law Review** (2013) 1163

¹¹⁵⁴ Casey and Niblett note, that some may argue that its independence exacerbates the regulatory capture problem, because the executive has less direct control and the industry is especially influential, *supra* note 978 at 1180-1181. It is reasonable to view this as trading capture from one constituency for capture from another, Barkow, *op. cit.*, at 34-35

¹¹⁵⁵ See, Fisch, J.E., *Top Cop or Regulatory Flop? The SEC at 75*, 95 **Virginia Law Review** (2009) 785; Bratton, W.W. and McCahery, J.A., *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 **North Carolina Law Review** (1995) 1861

¹¹⁵⁶ Feldman and Lobel (2010), *supra*; Dyck *et al.* (2010), *supra*; Rapp (2012), *supra*; Engstrom (2012), *supra* note 1175

¹¹⁵⁷ Demuth, Ch. C. and Ginsburg, D.H., *White House Review of Agency Rulemaking*, 99 **Harvard Law Review** (1986) 1075; McGinnis, J.O., *Presidential Review as Constitutional Restoration*, 51 **Duke Law Journal** (2001) 901; Sunstein, C. R., *Paradoxes of the Regulatory State*, 57 **University of Chicago Law Review** (1990) 407; Bagley, N. and Revesz, R.L., *Centralized Oversight of the Regulatory State*, 106 **Columbia Law Review** (2006) 1260-1360; Bubb, R. and Warren, P., *Optimal Agency Bias and Regulatory Review* (N.Y.U. Pub. L. & Legal Theory Research Paper Series, Paper No. 12-69; N.Y.U. Law & Economics Research Paper No. 12-47, Jan. 15, 2013), [online] Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2201042. Accessed 9 November 2014; Nou, J., *Agency Self-Insulation Under Presidential Review*, 126 **Harvard Law Review** (2013) 1755

royalties on oil and gas taken from Federal lands¹¹⁵⁸. The MMS was disgraced in 2008 when it came to light that its employees received lavish gifts from oil and natural gas companies' representatives, and were engaged in improper relationships with some of them¹¹⁵⁹. After whistleblowers alleged that the MMS was duped out of royalties on federal oil or gas, the Department of Interior's investigative report uncovered a scheme where lucrative contracts had been awarded improperly with major conflicts of interest. Though In several cases the Department of Justice declined to prosecute the offenders, eventually it failed to prevent the case from going forward¹¹⁶⁰.

It might be argued that the political system finally provided the appropriate check on the two influential government departments' failure to pursue claims in those cases. But replacing the cumbersome political mechanism with *qui tam* process would be a simpler solution. The court-centric private-plaintiff mechanism seems more effective and straightforward than elephantine system of checks and balances to overcome a regulatory-capture and political morass¹¹⁶¹.

On practical grounds, legislators may impose private enforcement regimes with dual purpose, aiming to create guards against both under enforcement as well as over enforcement by the bureaucracy¹¹⁶². The elaborate *qui tam* scheme in which whistleblowers are vested with independent enforcement authority via a private right of action can counterbalance

¹¹⁵⁸The MMS has been replaced by the Bureau of Ocean Energy Management and the Bureau of Safety and Environmental Enforcement. See *The Reorganization of the Former MMS*, BOEM [online] Available at: <https://www.boem.gov/Reorganization/>. Accessed on 10 August 2016

¹¹⁵⁹ Casey and Niblett (2014), *supra* note 978 at 1182

¹¹⁶⁰ *Ibid.*, p.1183

¹¹⁶¹ Rapp, G. Ch., *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, **Brigham Young University Law Review** (2012) 73-135; Bucy, *supra* note 454

¹¹⁶² Farhang, S., (2010). *The Litigation State: Public Regulation and Private Lawsuits in the U.S.* Princeton University Press, pp.94-128

uncertainty about agency enforcement in two ways. Most importantly, it can operate as a simple substitute for, or adjunct to public enforcement. Further, it can bring attention to violations going unaddressed by public agencies charged with enforcement responsibilities and thereby shame or prod them into action¹¹⁶³. Given the tendency of the sources of under enforcement identified above to vacillate over time, *qui tam* plaintiffs perform what Coffee (1983) called a “failsafe function,” by “ensuring that legal norms are not wholly dependent on the current attitudes of public enforcers . . . and that the legal system emits clear and consistent signals to those who might be tempted to offend.”¹¹⁶⁴

Generally speaking, the decentralised nature of *qui tam* enforcement litigation, as contrasted with centralised bureaucracy, can also encourage policy innovation for reasons similar to those associated with federalist governing arrangements¹¹⁶⁵. As distinguished from the imposition of a policy solution at the top of a centralised and hierarchical bureaucracy, litigation of an issue among many parties and interests, and across a number of jurisdictions, can lead to experimentation with a multiple policy responses to a problem, with successful policy solutions gaining traction and spreading.

The innovative solutions are needed, and moreover, inescapable given the specific nature of a white-collar crime. In the environment, where perpetrators are most likely powerful, highly professional, well-educated and well-paid ambitious individuals, and where the potential whistle-blowers are of that ilk, traditional models of crime prevention have limited effect.

¹¹⁶³ Cross (1989), *supra* note 949 at 215; Greve (1990), *supra* note 461 at 107; Zinn (2002), *supra* note 949 at 215

¹¹⁶⁴ Coffee (1983), *supra* note 923 at 209, p. 227

¹¹⁶⁵ Busch Ch.B. et al., *Taming Adversarial Legalism: The Port of Oakland’s Dredging Saga Revisited*, 2 **New York University Journal of Legislation and Public Policy** 179 (1999)

Those who are in possession of the strong industry specific evidence will be ready to trade it only under specific arrangements, which when agreed will be regarded as kind of contracts aimed at delivering some profit. Regulatory framework has yet to adapt to this environment, because it seems that public sends a clear message in regard of the corporate crime. Notably, *qui tam* is uniquely positioned to address this challenge. The next two sections analyse *qui tam* mechanism in the context of corporate world.

***Qui Tam* and Information Asymmetry**

Over the past decades, a rich body of literature has been developing that promotes non-traditional models of crime prevention. Recognising that crime is caused at least as much by opportunity as by moral failure or social dysfunction, criminologists such as Ronald Clarke and Marcus Felson have challenged the deeply held notion that crime reduction can only be achieved by solving large-scale socio-economic problems, or by altering the constitutional characteristics of criminals¹¹⁶⁶. The complementary frameworks of routine activity theory, crime pattern theory, and rational choice perspectives -- all suggest that it is a mistake to either focus too narrowly on the psychopathologies of individual offenders or to identify the underlying crime problems too broadly as ones arising out of poverty, relative deprivation, or other intractable social challenges¹¹⁶⁷. Instead, these — criminologies of everyday life¹¹⁶⁸

¹¹⁶⁶ Clarke, R. and Felson, M. (1993). *Routine Activity and Rational Choice: Advances in Criminological Theory*, Vol. 5, Transaction Publishers

¹¹⁶⁷ Clarke, R. V., "Situational Prevention, Criminology, and Social Values". In *Ethical and Social Perspectives on Ethical and Social Perspectives on Situational Crime Prevention*. (2000) (Von Hirsh, A., Garland, D., and Wakefield, A., eds., 97-98

¹¹⁶⁸ Garland, D. *The Limits of the Sovereign State: Strategies of Crime Control in Contemporary Society*, 36 **British**

define and study crime as a contextualised phenomenon, specific to the discrete, local circumstances in which it occurs¹¹⁶⁹.

The specific nature of white-collar crime is that it is committed by professionals, who can be exposed by the people of the same degree of knowledge, and who can produce industry specific evidence, which only insider can understand as such and explain its meaning to the relevant authorities and judge. It remains an open question, whether even by combining resources and insider knowledge, the government agencies, industry relators and specialised law firms have the necessary ability to address the problem of egregious information asymmetry the law enforcement has to solve when they deal with a sophisticated white-collar crime.

Orsini Broderick (2007)¹¹⁷⁰ describes the challenges the public enforcers meet when they embark on the investigation of the fraud against the government in the health industry, and explains why the *qui tam* relators hold the key to a viable solution. This ability to enhance effectiveness of the enforcement in respect of the fraud related to medical assistance has become even more important after the US Congress adopted the Affordable Care Act in 2010¹¹⁷¹.

Unlike contractor fraud, which can be equally detected and deterred by suits initiated by either the law enforcement agency or a relator, there are a number of reasons why it may be

Journal of Criminology (1996) 445

¹¹⁶⁹ Clarke and Felson, *supra* note

¹¹⁷⁰ Orsini Broderick (2007), *supra* note 566 at 126, pp. 982-984

¹¹⁷¹ *Ibid.*

more difficult for the Department of Justice to spot fraud related to medical assistance than other types of fraud. These reasons include:

- Substantive differences between medical assistance fraud and contractor fraud
- Issues of privacy only present in medical assistance fraud
- The huge number of Medicaid claims
- The substantial autonomy given to medical professionals not present in other fields.

A key reason why the Department of Justice has more difficulty spotting fraud related to medical assistance than contractor fraud is the substantive differences between the two fields. Both fields require highly specialised knowledge to identify fraudulent practices. However, the type of expertise needed to discover the fraud is different. Identifying contractor fraud mostly requires legal expertise, while discovering health care fraud requires specific medical knowledge. The prosecutorial authorities generally possess the former, but rarely possess the latter. Accordingly, the Department needs the assistance of a *qui tam* plaintiff to spot health care fraud, but not contractor fraud¹¹⁷².

Contractor fraud often involves knowingly violating “arcane rules and regulations surrounding defense acquisition practices” that are “extremely complicated.”¹¹⁷³ Thus, to discover this type of fraud, a clear understanding of these laws is necessary. Once that knowledge is

¹¹⁷² *Qui tam* plaintiffs generally come from within the industry. Ross, M. and Brannon, J., *False Claims Act and Qui Tam Litigation: The Government Giveth and the Government Taketh Away (and Then Some)*, 68 **Journal of the Bar Association of the State of Kansas** 20 (1999) (noting that “whistleblowing by employees and competitors comprises most of the *qui tam* lawsuits filed”, p.28)

¹¹⁷³ Phillips, J.R., *Qui Tam Litigation: A New Forum for Prosecuting False Claims Against the Government*, 14 **Journal of Legal Medicine** 267 (1993), p.272

obtained, spotting fraud requires no further expertise¹¹⁷⁴. The prosecutors' offices, staffed with lawyers, will generally possess the necessary legal expertise. *Qui tam* plaintiffs, on the other hand, generally come from within the industry, and as contractors, only a minority of them has a legal background. Accordingly, the prosecutorial authorities are much more suited to discover contractor fraud than a *qui tam* plaintiff.

Unlike contractor fraud, where the necessary expertise is knowledge the government law enforcement is likely to possess, health care fraud requires an expertise that only medical professionals are likely to have. Common health care fraud includes administering and billing for an excessive dosage of medication or an unnecessary procedure¹¹⁷⁵, charging for procedures and tests not performed¹¹⁷⁶, and prescribing unsolicited and unnecessary medical equipment to elderly patients¹¹⁷⁷. To determine whether or not any of these practices are fraudulent, one first has to make a medical determination, such as determining that a dose of medication provided was, in fact, excessive. The DOJ's officers generally do not have the medical knowledge to make their knowledgeable judgments. On the other hand, *qui tam* plaintiffs who are immersed in the medical community and have some level of medical training will have this knowledge. Therefore, *qui tam* plaintiffs are more suited to identify health care fraud than the Department of Justice

Another important issue unique to the health care industry is the great need for privacy between health care provider and patient. Privacy is "a deeply imbedded value in American

¹¹⁷⁴ *Ibid.* (providing description of most common forms of contractor fraud)

¹¹⁷⁵ Pontell, H.N., Jesilow P.D. and Geis, G., *Policing Physicians: Practitioner Fraud and Abuse in a Government Medical Program*, 30 **Social Problems** 117 (1982)

¹¹⁷⁶ Phillips (1993), *supra* note 929, p. 273

¹¹⁷⁷ *Ibid.*

culture” and “is considered an essential ingredient to individual autonomy and a free society.”¹¹⁷⁸ The Supreme Court has long acknowledged that “[v]arious guarantees [in the Constitution] create zones of privacy.”¹¹⁷⁹ Health care is one area where this right has been deemed very significant¹¹⁸⁰. Although some scholars have argued that the community’s interest in projects that use medical surveillance to detect healthcare fraud should trump a patient’s desire for confidentiality¹¹⁸¹, the majority view rejects this proposition. Instead, most scholars argue that “the Fourth Amendment ‘reasonable expectation of privacy’ standard is eroded if the citizen now must anticipate that medical and financial records are widely accessible to the public.”¹¹⁸² In light of this academic debate, the Department of Justice is permitted to use surveillance methods in detecting medical fraud, but this power is limited by statute¹¹⁸³. *Qui tam* plaintiffs, on the other hand, are generally already privy to all of the personal information that is necessary to uncover health care fraud¹¹⁸⁴. For this reason, the privacy concerns implicated when the government law enforcers look for health care fraud are not implicated in the same way as when a *qui tam* plaintiff does so. As a result, *qui tam* plaintiffs have an advantage in uncovering health care fraud over the Department of Justice.

¹¹⁷⁸ Hatch, M., *HIPPA: Commercial Interests Win Round Two*, 86 **Minnesota Law Review** 1481 (2002)

¹¹⁷⁹ *Griswold v. Connecticut*, 381 U.S. 479, 482–84 (1965) (noting that zones of privacy can be found in First, Third, Fourth, Fifth, Ninth, and Fourteenth Amendments)

¹¹⁸⁰ Both federal and state governments have enacted legislation intended to protect the patients’ privacy in health care. See, Health Insurance Portability and Accountability Act of 1996, 42 U.S.C. § 1320d-2 (2000) (addressing privacy of health care information); 42 U.S.C. § 290dd-2 (providing for confidentiality of records related to certain medical treatments); Md. Medical Records Confidentiality Act, Md. Code Ann. Health-Gen § 4-302 (LexisNexis 2005) (addressing privacy of health care information)

¹¹⁸¹ Gostin, L. O., and Hodge, J. G., Jr., *Personal Privacy and Common Goods: A Framework for Balancing Under the National Health Information Privacy Rule*, 86 **Minnesota Law Review** 1439 (2002)

¹¹⁸² Hatch (2002), *supra* note 934, p. 1486

¹¹⁸³ *Ibid.*

¹¹⁸⁴ As previously noted, *qui tam* relators generally come from within the industry (*supra*). This implies that in the context of medical fraud, they will already have access to patients’ medical records

A third feature unique to the health care industry which makes health care more susceptible to claims by *qui tam* plaintiffs is the huge volume of Medicaid claims¹¹⁸⁵. Because of the enormous number of claims submitted, “the Department of Health and Human Services is simply unable to detect the vast amount of fraud that regularly occurs.”¹¹⁸⁶

The number of government contracts, on the other hand, is substantially fewer.¹¹⁸⁷ Accordingly, the DOJ needs the assistance of *qui tam* plaintiffs in the former case, but not in the latter.

Another reason why it may be more difficult for the DOJ to spot fraud related to medical assistance than contractor fraud is the level of autonomy that physicians possess. “Physicians as a professional group enjoy a high level of autonomy in practicing medicine...”¹¹⁸⁸ As a result, physicians who engage in fraud are able to participate in what Katz has labeled “pure” white collar crime:¹¹⁸⁹

In the purest “white-collar” crimes, white-collar social class position is used: (1) to diffuse criminal intent into ordinary occupational routines so that it escapes unambiguous expression in any specific, discrete behaviour; (2) to accomplish the crime without incidents or effects that furnish presumptive evidence of its occurrence before the criminal has been identified; and (3) to cover up the culpable knowledge of participants through concerted action that allows each to claim ignorance¹¹⁹⁰.

¹¹⁸⁵ Phillips (1993), *supra* note 929 at 211, pp. 272–273

¹¹⁸⁶ *Ibid.*

¹¹⁸⁷ *Ibid.*

¹¹⁸⁸ Pontell *et al.* (1982), *supra* note 931 at 211, p. 117

¹¹⁸⁹ Katz, J., *Legality and Equality: Plea Bargaining in the Prosecution of White-Collar and Common Crimes*, 13 **Law & Society Review** 431 (1979)

¹¹⁹⁰ *Ibid.*, p.435

According to scholars who have studied this classification of crime, undertaking these practices makes “the search for evidence of wrongdoing both difficult and complex.”¹¹⁹¹ As a result, it can be expected that the parties most likely to be able to uncover this type of fraud are those closest to the physician—in other words, *qui tam* plaintiffs. In direct contrast with physicians, contractors have very little autonomy. The terms of the contract under which they were hired vastly limit their discretion, thus alleviating any special reason to rely on *qui tam* plaintiffs.

The world of big finance and multinational corporations presents comparable challenge to penetrate in search of incriminating evidence. In the gigantic financial institutions there may be only a few people understanding a specific financial product. In a large corporation only a few gifted engineers may know about sophisticated equipment that allows their company to profiteer by playing with environmental standards. So the question is whether *qui tam* mechanism, which includes both bounty and potential suit, offers what the insiders need to encourage them to come forward?

It is where Mertonian theory of deviance that may provide a clue to the answer. It is based on Robert Merton’s analysis of the relationship between culture, structure and “anomie” (normlessness), published in 1938. Merton defines culture as an “organized set of normative values governing behavior which is common to members of a designated society or group”¹¹⁹². Social structures are the “organized set of social relationships in which members of the society or group are variously implicated”¹¹⁹³. Anomie, the state of normlessness, arises when there is “an acute disjunction between the cultural norms and goals and the socially

¹¹⁹¹ Pontell *et al.* (1982), *supra* note 931 at 211, p. 120

¹¹⁹² Merton, R. K. (1968). *Social Theory and Social Structure* (Enlarged ed.). Free Press, New York, p.45

¹¹⁹³ *Ibid.*

structured capacities of members of the group to act in accord with them¹¹⁹⁴. In his theory, Merton linked anomie with deviance and argued that the discontinuity between culture and structure had the dysfunctional consequence of leading to deviance within society¹¹⁹⁵. Merton's theory postulates that when cultural norms and structured capacities clash one of the possible outcomes is what American sociologist called "innovation", which in fact often takes form of crime.

Applying this framework to the corporate world can help to understand the roots of white-collar crime. The multinationals are stuffed with ambitious hard-working people, with mostly pecuniary motives, derived from the corporate culture that values financial success most. As it was shown above¹¹⁹⁶, they are ready to sacrifice their private lives in exchange to promise of high financial rewards. When such promises for some reason do not materialise, then one of the reaction may be "innovation" – the disgruntled employees financially rewarding themselves. The reasons to come forward with evidence in respect of corporate fraud in such an environment may be closely related to those underlying decision to commit crime. Such reasons may include envy, grieve, anger, revenge, or greed – calculated decision to take a pension pot as a lump sum.

Qui tam is uniquely positioned to give an answer to all of the demands of potential whistleblowers. The reward may not be of a prime concern of them, if they are high-ranking employees they are more or less confident that their information is valuable. They may be more worried that administrative agency can be captured and will not investigate due to its

¹¹⁹⁴ *Ibid.*

¹¹⁹⁵ Ritzer, G., (2007). *Sociological Theory* (7 ed.). McGraw-Hill Higher Education. pp. 251–257

¹¹⁹⁶ See this Chapter, section "Economic Analysis of *Qui Tam* Relators' Behaviour"

cozy relationship with the too big to fail bank or company. Alternative root to reward through litigation secures confidence of relators that potential administrative capture will not prevent them from getting rich. It is clear that *qui tam* suits are much more valuable in the context of any area with deep inside knowledge and high level of narrow specific expertise often acquired through many years of particular employment. The *qui tam* relators are uniquely able to provide the regulatory world with what Bucy (2002)¹¹⁹⁷ identified as “an essential commodity” -- inside information about wrongdoing -- that cannot be found elsewhere.

The possibility that any colleague may come forward as an informant serves as efficient deterrence as only a minor part of white-collar crime is committed by lone perpetrators¹¹⁹⁸. It is reasonable to assume that by increasing probability of breach of trust among potential corporate fraudsters *qui tam* contributes to increase in deterrence. However, this requires a further research, which may receive a negative response from the corporate world.

Addressing the problem of information asymmetry, *qui tam* as an enforcement regime has comparative informational advantages for detecting violations. Potential relators-enforcers — who are not directly affected by violations, but whose proximity to misdeeds gives them highly valuable inside information, and whose connections to the relevant industry may give them necessary expertise to judge violations — collectively have knowledge about violations that far exceeds what the administrative state could achieve through monitoring even under the most optimistic budget scenarios. As the massive governmental expenditures required detecting and investigating misconduct are no match for the millions of ‘eyes on the ground’ that bear knowledgeable witness of violations.

¹¹⁹⁷ Bucy, P.H., *Information As a Commodity in the Regulatory World*, 39 **Houston Law Review** 905 (2002)

¹¹⁹⁸ Bucy, *op. cit.*

So far the angle of discussion on the merits of *qui tam* positioned corporations either as potential violators, or potential victims. This view, however, may not necessarily be so pessimistic as some new data sheds light on potential – as well as actual -- benefits that whistle blowing rings to corporations. The emerging empirical evidence is analysed in the last section of this chapter.

***Qui Tam* Enforcement and a Corporation: Empirical Evidence of Mutual Benefit**

The purpose of this part is to review available to date empirical evidence, and by identifying characteristics of firms subject to external financial whistleblowing allegations, to examine more long-term economic consequences of such allegations. These allegations labelled “external” because they have risen to prominence outside of the organisations; cases of whistleblowing that were resolved internally normally are not in a public domain. The allegations are “financial” because they include alleged earnings mismanagement, improper disclosure, insider trading, price-fixing, tax fraud, and violations of securities’ regulations.

It does not merit arguing that *qui tam* enforcement mechanism has enormously benefited from the corporate sector. As long as corporations exist, and they engage as contractors with the US government, the concomitant attempts to defraud government agencies will appeal to the potential *qui tam* relators with hefty bounties paid for crucial evidence of their employers’ wrongdoings. A converse proposition that a corporate sector has benefited from the *qui tam* enforcers has yet to be corroborated in the face of a strong opposition.

Sceptics argue that (1) *qui tam* reduces prosecutorial discretion, its relators often misjudge the situation and indulge in trivial complaints or frivolous suits in pursue of bounties¹¹⁹⁹, thus destabilising the corporate sector; (2) “Machiavellian” whistle-blowers who have an axe to grind lodge baseless allegations, divert resources and clog judicial system¹²⁰⁰; (3) ineffective workers abuse a protected “whistle-blower” status to avoid discharges or disciplinary proceedings¹²⁰¹. Those who oppose *qui tam* in particular, and whistleblowing advancement in general, argue that instead of noisy public allegations the potential whistle-blowers should voice their concerns through internal corporate channels, and deliver their messages to the management first and foremost, not to external – alien -- bodies¹²⁰².

Notable anecdotal evidence suggests that whistle-blowers can make a difference, however, the key question from the business perspective is whether that difference epitomises the rule of law, triumph of justice and exposure of fraud (at a high price, though), or after incurring a heavy financial burden on the companies, its management and shareholders they eventually made a corporation stronger?

The findings may shed light on the role of employee whistle-blowers through the economics’ framework. From a strategy perspective three sets of questions need close examination:

- What is the immediate stock market reaction to an external financial whistleblowing announcement? Do these stock price reactions vary with the nature of the allegation?

¹¹⁹⁹ *Supra*, Chapter II

¹²⁰⁰ Gobert, J., and Punch, M., *Whistleblowers, the Public Interest, and the Public Interest Disclosure Act 1998*. 63 **The Modern Law Review** 25 54 (2000)

¹²⁰¹ Schmidt, M. 2003. *Whistle Blowing Regulation and Accounting Standards Enforcement in Germany and Europe — An Economic Perspective*. Berlin, Germany: Humboldt-Universität zu Berlin Wirtschaftswissenschaftliche Fakultät, Department of Business and Economics

¹²⁰² Miceli, M. P., and Near, J. P., *Characteristics of Organizational Climate and Perceived Wrongdoing Associated with Whistleblowing Decisions*. 38 **Personnel Psychology** 525–544 (1985)

- What are the subsequent economic consequences for firms subject to external financial whistle-blowing events? Do these firms experience more earnings restatements, more shareholder lawsuits, and poorer future operating and stock return performance?
- Do firms respond to whistleblowing allegations by improving their governance structure?

The analysis follows methodology developed by Bowen *et al.* (2010)¹²⁰³, and data from the U.S. government's Occupational Safety and Health Administration office (OSHA), the agency responsible for handling complaints of discrimination from whistle-blowers. Bowen suggested 81 employee whistleblowing allegations related to financial misconduct between 1989 and 2004 reported in the financial press, plus 137 instances of employee whistleblowing between 2002 and 2004 obtained from records of OSHA. The companies in the sample were not those who exclusively had been subjects of *qui tam* filings. Due to *qui tam* enforcement applicability only to the areas where fraud took place against the government, the exclusively *qui tam* sample of companies would be less representative focusing predominantly on two sectors – healthcare and defence¹²⁰⁴. To avoid overly sector specific scope of analysis the sample was diluted with other whistleblowing cases to broaden its economic base.

Bowen *et al.* argue that whistleblowing allegations are a function of management's opportunity and incentives to engage in financial wrongdoing, which are related to the specific characteristics of the companies¹²⁰⁵. The companies in the sample shared the

¹²⁰³ Bowen, R.M., Call, A.C. and Rajgopal, Sh., *Whistle-Blowing: Target Firm Characteristics and Economic Consequences*, 85 *The Accounting Review* American Accounting Association 4 1239–1271 (2010)

¹²⁰⁴ *Ibid.*, p.1246

¹²⁰⁵ *Ibid.*

following characteristics: firms were large, growing, successful in their prior stock return performance, and highly regarded; they were under pressure from capital markets to continue showing good financial results, experienced downsizing, and did not score high in terms of corporate governance and external monitoring; not surprisingly, when the potential benefits to the whistle-blower increased (through *qui tam* model), the companies were more likely to face public allegations of wrongdoing¹²⁰⁶.

The companies with a propensity to mutiny by the bounties

Companies, which are subject to capital market pressure, are more likely to suffer from the management abusing their office. In recent years, firms have faced heightened capital market pressure to deliver sustained earnings growth. Such pressures have likely created incentives for some managers to aggressively boost earnings, either via earnings management or via other questionable practices such as overbilling customers or improper disclosure of material financial events. As a result, those firms, which have been subject to capital market pressure, are more likely to experience a whistleblowing event.

Firms that are *rapidly growing* are more likely to outgrow their controls. Responsibility for overall decision-making is typically spread across many individuals, and as a firm grows and responsibility is spread over more individuals, each individual has less information and authority to stop wrongdoing.

Firms with *strong past stock market performance* are more likely to be a target of whistleblowing. Their employees might be more likely to expose financial misdeeds perceived to enable the firm to artificially achieve strong performance.

¹²⁰⁶ *Ibid.*

A highly regarded firm *with solid reputation* is more likely to attract the ire of a disgruntled employee and the resulting allegation is more likely to be newsworthy. The external whistleblower or the media outlet is likely to get more attention from exposing wrongdoing at a highly regarded company.

The employee's motivation to resort to external whistleblowing is higher when channels for raising concerns within the company are unclear. This situation likely occurs in at least two cases. First, Rothschild and Miethé (1999)¹²⁰⁷ suggest that bureaucratic and *undemocratic work environments* are likely to experience higher levels of external whistleblowing because of significant barriers to effective internal whistleblowing. Second, King (1999)¹²⁰⁸ argues that *geographical distance* and multiple industrial segments in a firm make communication channels less clear.

Luthans and Sommer (1999)¹²⁰⁹ find that following *employee downsizing*, employees experience a decline in both loyalty and commitment to the firm. Consequently, the employees (especially former employees, who have been let go) are more likely to make public allegations following layoffs. Further, layoffs can increase the level of animosity between the firm and existing employees, and if existing employees perceive their job as being less secure, the potential cost of blowing the whistle decreases.

¹²⁰⁷ Rothschild, J., and Miethé, T. D., *Whistle-blower Disclosures and Management Retaliation: The Battle to Control Information About Organization Corruption*. 26 **Work and Occupations** 1 107–128 (1999)

¹²⁰⁸ King, G. *The implications of an organization's structure on whistleblowing*. 20 **Journal of Business Ethics** 4 315–326 (1999)

¹²⁰⁹ Luthans, B. C., and Sommer, S.M., *The impact of downsizing on workplace attitudes*. 24 **Group & Organization Management** 1 46–70 (1999)

Employees of *large firms* are likely to be more confident that their allegations will have an audience, and therefore it is assumed that employees of large firms will be more likely to make allegations of financial wrongdoing.

Internal controls weaknesses, which are defined as “a significant likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected”¹²¹⁰, lead to the increased probability of internal conflict. The employees are more likely to resort to external whistleblowing when the firm has poor internal controls.

On the other hand, managers are more likely to engage in financial misconduct when *the quality of external monitoring is poor*. To capture such external monitoring two empirical proxies have been identified: (1) the presence of block holders, and (2) public pension funds ownership.

Managers are more likely to indulge in wrongdoing in the presence of *weak corporate governance* and strong private incentives. To capture the quality of internal governance, the list of seven empirical proxies was applied:

- CEO wealth defined as the sum of the CEO’s salary, bonus, the value of stock ownership, and the value of all in-the-money options
- The number of directors on the firm’s board of directors in the year before the whistleblowing event
- The percentage of directors who are insiders in the year before the whistle-blowing event
- Whether the firm’s CEO was also the chairman of the board in the year before the whistle-blowing event

¹²¹⁰ Public Company Accounting Oversight Board (PCAOB). *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. Auditing Standard No. 2. Washington, D.C.: PCAOB (2004)

- The percentage of directors who were serving on at least three other corporate boards in the year before the whistle-blowing event
- The percentage of board members who attended at least 75 per cent of the board committee meetings in the year before the whistle-blowing event
- If the firm has a new CEO in the year before the whistle-blowing event.

When the company is a *qui tam specific* the entrepreneurial employees have the opportunity to benefit financially as potential whistle-blowers by uncovering corporate misdeeds. The majority of *qui tam* cases fall into one of two industries: healthcare and defence contracting. Over 70 per cent of the funds recovered as part of the *qui tam* provisions relate to matters in which the Department of Health and Human Services is the primary agency, while over 15 per cent of the recovered funds pertain to matters in which the Department of Defence is the primary agency¹²¹¹. The *qui tam* provisions provide employees in the healthcare and defence industries with increased incentives to become relators.

The scale and scope of corporate fraud

Any research into the short-term and long-term consequences of employee driven exposure of corporate misdeeds would be one-sided without at least brief overview of the quantitative and qualitative characteristics of the contemporary corporate fraud. The most recent discharge of the academic knights who have been researching corporate fraud for over decade brings their focus on the pervasiveness of the companies' wrongdoings¹²¹². Using the dataset of frauds from their previous research¹²¹³, Dyck, Morse and Zingales developed a comprehensive sample of frauds from Security Class Action cases. The frauds include those

¹²¹¹ Taxpayers Against Fraud (TAF). 2015. The False Claims Act Legal Center. [online] Available at: <<http://www.taf.org/>> (accessed on 5 August 2015)

¹²¹² Dyck *et al.*, (2013), *supra* note 772 at 165

¹²¹³ Dyck *et al.*, (2010), *supra* note 13 at 10

involving financial misrepresentations, but not limited to those. The sample relies on the fact that the security class action system provides strong incentives (for attorneys and shareholders) to file suit whenever a fraud that is likely to have a material impact is revealed¹²¹⁴.

With the dataset the authors tackled the question of unobservable fraud by appealing to basic probability rules for guidance of going from observed data of the joint event of engaging in fraud and being caught, to the actual variable of interest, the probability of engaging in fraud regardless of whether the perpetrators are caught or not¹²¹⁵. The identification strategy employed exploits circumstances in which the likelihood of being caught increases significantly. By comparing the differences in detection in this special circumstance, and in normal circumstances, the authors produced an estimate of the iceberg (i.e. the normal detection likelihood), and then go a next step to estimate the unconditional pervasiveness of engaging in fraud¹²¹⁶.

The authors take advantage of the natural experiment created by the demise of Arthur Andersen that forced all firms that previously had Andersen as their auditor to seek another auditor¹²¹⁷. The scandal enhanced the incentives of new auditors to be active. As a result, Dyck *et al.* have found that the incidence of fraud detection by auditors goes up by a multiple of close to four¹²¹⁸. This gives a sense of how much undetected fraud exists more generally, with the iceberg being 3 times bigger under the water than above the water. Thus the authors

¹²¹⁴ Dyck *et al.*, (2013), *supra* note 772 at 165, p. 3. For large companies, it is highly unlikely that detected frauds exist without a corresponding class action suit

¹²¹⁵ *Ibid.*, pp.5-7

¹²¹⁶ *Ibid.*, pp.8-10

¹²¹⁷ *Ibid.*, pp.10-11

¹²¹⁸ *Ibid.*, p.12

arrive at their best estimate that 14.5 per cent of large publicly traded corporations engage in fraud¹²¹⁹, with a very conservative lower bound estimate close to 5.6 per cent¹²²⁰.

The next step of the research was to estimate the social costs of fraud. Dyck *et al.* construct a new measure of the cost of fraud, which they define to be equal to the difference between the enterprise value after the fraud is revealed and what the enterprise value of the company would have been in the absence of fraud¹²²¹. Using this approach, the authors estimate that the median loss of the enterprise value of the fraudulent companies (the firms' enterprise value prior to the beginning of fraud was set as the benchmark) comes up at 20.4 per cent¹²²². Putting the estimate of the extent of fraud with the estimate of the cost per firm of fraud, the research produces an estimate of the social cost of fraud for these firms as a percentage of their enterprise value. The final price tag turns out to be an astonishing 3 per cent of the enterprise value of all large corporations¹²²³.

In their next attempt to identify the most effective mechanisms for detecting corporate fraud Dyck, Morse and Zingales conducted the most profound and complex study to date of all reported fraud cases in large American companies between 1996 and 2006¹²²⁴. The time frame of the study partially overlaps with that of the analysis carried out in this Chapter¹²²⁵. The key question they had asked themselves later made the title of their research paper -- "Who blows the whistle on corporate fraud?" The findings of the study were hardly surprising

¹²¹⁹ *Ibid.*, p.13

¹²²⁰ *Ibid.*, p.15

¹²²¹ The hypothetical value is constructed by making projections from the pre-fraud period, with assumption the trajectory would have followed that of other firms in the same industry (*Ibid.*, p. 25)

¹²²² *Ibid.*, p.26

¹²²³ Dyck *et al.*, (2013), *supra* note 772 at 165, p.29

¹²²⁴ *Ibid.*

¹²²⁵ 1989-2004 (Bowen *et al.* (2010), *supra* note 1035 at 241)

to those who followed the media reports on the scandals and litigations related to the fall of the structured finance.

As it was mentioned above, the classification of whistle-blowers developed by the authors was not in complete match with the way the Sarbanes-Oxley, False Claims Act and Financial Reform Act define them. But the broader approach pursued by the North American academics highlighted the problem with traditional reliance of US regulators rather on the web of institutional whistle-blowers than on individual guerrilla fighters. The study has found that fraud detection does not rely on obvious actors (investors, SEC, auditors), but takes a village of several non-traditional players (employees and media) with surprisingly effective role of industry regulators¹²²⁶.

The analysis of whistle-blowers' incentives suggests that positive reputational and career incentives tend to be weak, except for journalists. For this category, however, the incentives exist only for very large frauds in famous companies. On the contrary, monetary incentives seem to work well, without the negative side effects often attributed to them. Moreover, as the study shows, monetary incentives for fraud revelation play a role regardless of the severity of the fraud. In particular, in healthcare (an industry where the government employs a bounty system for whistle-blowers through *qui tam* provisions) 41 per cent of frauds are brought to light by employees. This contrasts with only 14 per cent of cases detected by employees in all other industries¹²²⁷. Hence, the study provides empirical evidence that a strong monetary incentive to blow the whistle does motivate people with information to come forward.

¹²²⁶ Dyck *et al.*, (2013), *supra* note 772 at 165, *Ibid.*

¹²²⁷ *Ibid.*, p.4

The data provided by the study allows testing the still dominant views on who should detect financial fraud. While, the legal view¹²²⁸ claims fraud detection belongs to auditors and securities regulators, the private litigation view¹²²⁹ attributes it to law firms. And the finance view¹²³⁰ argues that monitoring should be done by those with residual claims (equity and debt holders) or their agents (analysts and auditors).

The study provides support neither for the legal view, since the SEC accounts for only 7 per cent of the cases and auditors -- for 10 per cent, nor for the private litigation view (3 per cent of the cases). The finance view also finds a weak support: debt holders were rare; equity holders play only a trivial role, having detected just 3 per cent of the cases. Equity holders' agents (auditors and analysts) collectively account for 24 per cent of the cases analysed. But the actors with no residual claims in the firms involved and therefore are traditionally considered as much less important players in the corporate governance arena, turned out to play a key role in fraud detection: employees (17 per cent of the cases), non-financial-market regulators (13 per cent), and the media (24 per cent)¹²³¹.

Immediate stock market reactions to whistleblowing announcements

¹²²⁸ Black, B. *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 (1) **UCLA Law Review** 781-855 (2001)

¹²²⁹ Coffee (1996), *supra* note 466 at 108

¹²³⁰ Fama, E. F. and Jensen, M. C., *Separation of Ownership and Control*. Jensen, M. *Foundations of Organizational Strategy*, Harvard University Press, 1998, and 26 **Journal of Law and Economics**, (June 1983), [online]. Available at SSRN: <<http://ssrn.com/abstract=94034> or <http://dx.doi.org/10.2139/ssrn.94034> > (accessed on 8 June 2013)

¹²³¹ Dyck *et al.* (2013), *supra* note 772 at 165, p. 5

The analysis rendered in this Chapter¹²³² continues where the study of Dyck *et al.* stops – the financial consequences the corporations have to endure following denouncement by whistleblowers.

The data available presents evidence on the stock market reaction to whistleblowing events measured around five days, from the day before the announcement to three days after (day -1 through day +3). The mean five-day abnormal market-adjusted stock market reaction was -2.84 per cent¹²³³. The median abnormal reactions, while smaller in magnitude, were also significantly negative. Given that the median market capitalisation of a firm from the sample was \$7.3 billion¹²³⁴, market reactions following whistleblowing allegations resulted in significant losses in shareholder value. The frequency of negative reactions was also high, at 67.9 per cent of the sample¹²³⁵.

This significant volatility suggests that, on average, announcements of whistleblowing allegations were economically important for the targeted firm and were not immediately seen as frivolous by stock market participants. It is worth noting that the time frame of the analysis is confined to the era before the advent of high frequency trading with subsequent rise in general volatility of the stocks.

Remarkably the stock market viewed whistleblowing allegations relatively negatively for firms with alleged earnings management. Specifically, indicating that allegations related to earnings management resulted in an average incremental (overall) -14.3 per cent (-7.3 per cent) return

¹²³² Bowen *et al.* (2010), *supra* note 1035 at 241

¹²³³ *Ibid.*, p.1253

¹²³⁴ *Ibid.*

¹²³⁵ *Ibid.*

over the five-day window¹²³⁶. Allegations of overbilling indicate an average incremental (overall) -7.4 per cent (-0.4 per cent) five-day return¹²³⁷. Hence, it appears that, on average, whistleblowing events were far from trivial for targeted firms, particularly for firms accused of managing earnings.

Long-term consequences of whistleblowing events

Long-term consequences for the purposes of this analysis are understood as: (a) earnings restatements, (b) shareholder lawsuits, (c) future operating performance, and (d) future stock market performance. If a whistleblowing event reveals financial reporting or agency problems in the firm, then one would expect firms subject to such allegations to be more likely to file future earnings restatements, to be the target of shareholder lawsuits, and to suffer weak future operating and stock return performance.

It should be recognised that the issue of endogeneity in evaluating the consequences of whistleblowing events must be addressed. While assessing future economic consequences such as operating or stock return performance, it is possible that whistleblowing allegations arise from many of the same economic forces that contribute to subsequent problems after a whistleblowing allegation. Hence, it would be inappropriate to treat the whistleblowing event as exogenous.

Control for the potential endogeneity between whistleblowing allegations and future economic consequences should be carried out by comparing whistleblowing targets to a sample of control firms matched on the propensity to experience a whistleblowing event

¹²³⁶ Bowen *et al.* (2010), *supra* note 1035 at 241, p.1252

¹²³⁷ *Ibid.*, p.1254

(Armstrong *et al.* 2009¹²³⁸; Francis and Lennox 2008¹²³⁹). As Bowen *et al.* point out, the primary benefit of using a control sample matched on propensity scores is that it allows to compare whistleblowing firms to a set of firms that are the same on all observable dimensions, thus allowing to more clearly attribute any observed consequence to the whistleblowing event itself, rather than to the firm characteristics associated with whistleblowing allegations¹²⁴⁰. From a practical standpoint, this matched sample also allows to compare whistleblowing firms to control firms along a variety of dimensions (restatements, lawsuits, operating performance, stock return performance) without the need for additional control variables¹²⁴¹. In essence, this propensity-score matching procedure directly controls for any relevant difference between whistleblowing and control firms¹²⁴².

Subsequent earnings restatements

To assess subsequent consequences (in this and the following lawsuit-based tests), it is necessary to rely on the restatement and lawsuit samples with one major exception: whistleblowing firms that experienced a restatement or lawsuit are not eliminated, as the purpose of the analysis is to document the existence of such a link should it exist.

The results indicate that whistleblowing firms in the sample experienced significantly more subsequent restatements ($p=0.013$) in the three years following a whistleblowing action (17.9 per cent) than propensity-score matched control firms (7.5 per cent)¹²⁴³. Whistleblowing

¹²³⁸ Armstrong, C., A. D. Jagolinzer, and D. F. Larcker. *Chief Executive Officer Equity Incentives and Accounting Irregularities*. 48 **Journal of Accounting Research** 2 225–271 (2009)

¹²³⁹ Francis, J. R., and C. S. Lennox. *Selection Models in Accounting Research*. Working paper, 2008. University of Missouri and The Hong Kong University of Science and Technology

¹²⁴⁰ Bowen *et al.* (2010), *supra* note 1035 at 241, p. 1255

¹²⁴¹ *Ibid.*, p.1250

¹²⁴² *Ibid.*

¹²⁴³ Bowen *et al.* (2010), *supra* note 1035 at 241, p. 1256

firms from OSHA list also experienced more restatements (13.7 per cent)¹²⁴⁴ than propensity-score matched control firms (9.5 per cent)¹²⁴⁵, but the difference is not significant at conventional levels ($p= 0.141$). However, the subset of future restatements that represent accounting irregularities, as defined by Hennes *et al.* (2008)¹²⁴⁶, shows that OSHA firms were more likely to experience an accounting irregularity than their matched counterparts ($p= 0.053$)¹²⁴⁷.

In sum, firms exposed to whistleblowing events reported in the press were more likely to experience a subsequent restatement than were matched control firms with similar underlying characteristics¹²⁴⁸.

Subsequent shareholder lawsuits

The sample analysed for this test includes 67 firms and their 134 propensity-score matched control firms, and 95 OSHA firms along with their 190 matched control firms. The results indicate that whistleblowing firms in the sample experienced significantly more subsequent lawsuits ($p= 0.004$) following a whistleblowing action (26.9 per cent) than propensity-score matched control firms (11.9 per cent)¹²⁴⁹. The whistleblowing firms in the OSHA list also experienced more lawsuits (11.6 per cent) than propensity-score matched control firms (8.4 per cent), but the difference is not significant at conventional levels ($p =0.196$)¹²⁵⁰.

¹²⁴⁴ *Ibid.*

¹²⁴⁵ *Ibid.*

¹²⁴⁶ Hennes, K. M., Leone, A. J. and Miller, B. P. *The Importance of Distinguishing Errors from Irregularities in Restatement Research: The Case of Restatements and CEO/CFO Turnover*. 83 **The Accounting Review** 6 1487–1519 (2008)

¹²⁴⁷ Bowen *et al.* (2010), *supra*, *Ibid.*

¹²⁴⁸ Bowen *et al.* (2010), *supra* note 1035 at 241, p.1256

¹²⁴⁹ *Ibid.*

¹²⁵⁰ *Ibid.*

In summary, the evidence suggests that a whistleblowing event reported in the press can be an early warning indicator of future earnings restatements or shareholder lawsuits, and that whistle-blowing allegations are not trivial and/or baseless, on average.

Whistleblowing events and relatively poor future operating performance

The question is whether whistle-blowing allegations serve as an early warning of negative future operating or stock price performance. The link between a whistleblowing event and negative future performance can be motivated in at least in three ways. First, given the earlier evidence that whistleblowing can be a significant indicator of subsequent earnings restatements and lawsuits, it is perhaps natural to expect negative future performance subsequent to a whistleblowing exposure. Second, managers may engage in defensive actions to mitigate negative publicity and other consequences of a whistle-blowing scandal. Such defensive efforts can distract managers from normal profit-seeking activities and divert funds away from the strategic investments. Third, a whistleblowing event can hurt the firm's image with its stakeholders, resulting in a loss of confidence in management, increasing probability of management turnover, and increase the perception that additional problems are lurking.

Whistleblowing events and relatively poor future stock price performance

The analysis of data on future stock return performance of firms subject to whistleblowing allegations considers monthly returns over three years following the month in which the whistleblowing allegation becomes public. Thus, this event window does not overlap with the immediate consequences tests presented above¹²⁵¹. The data reveals that firms reported lower abnormal returns over the one, two, and three years following the exposure. Firms

¹²⁵¹ See pp. 250-251

from the OSHA list also reported lower returns over the subsequent two to three years¹²⁵². Firms exhibited lower returns in year +1 and year +2, while OSHA firms exhibited lower returns in year +2 and year +3¹²⁵³. In general, the firms targeted by whistle-blowers suffered lower returns in subsequent years, which in turn suggests that whistleblowing allegations on average were not frivolous and without merit.

Corporate governance improvement following a whistleblowing revelation

It is not clear whether firms will take meaningful actions to improve corporate governance following a whistleblowing event. For example, a targeted firm can easily initiate cosmetic changes such as replacing one set of inside directors with another set of insiders.

The corporate governance data available from 10-Ks and proxy statements sheds some light on the changes, which followed whistle-blower exposure. For the purposes of this analysis six aspects of governance, details of which have been discussed above, stay in the focus of consideration. The three-year changes in these six governance variables were calculated from the year before the whistleblowing event (year -1) to two years after the event occurred (year +2). Of the 81 (137) sample (OSHA) firms, it was impossible to find 10-Ks and/or proxy statements for 24 (47) firms¹²⁵⁴.

Since governance improvements were encouraged in the period following the accounting scandals and Sarbanes-Oxley, a governance data was collected for a sample of matched firms that were not subject to whistleblowing allegations. The matched firms were selected with

¹²⁵² Bowen *et al.* (2010), *supra* note 1035 at 241, p.1256

¹²⁵³ *Ibid.*

¹²⁵⁴ Bowen *et al.* (2010), *supra* note 1035 at 241, p.1264

the same four-digit SIC code, within the same stock exchange, and with net sales as close as possible to the whistleblowing firm's net sales for the year before the whistleblowing revelation.

The findings have showed that, compared to the matched control sample, firms publicly exposed to whistleblowing allegations were more likely to reduce the size of the board, reduce insider participation on the board, have less busy board members, and were more likely to replace the CEO.

There was no evidence that OSHA firms made changes in governance. Thus, on average, publicly exposed whistleblowing targets appeared to change governance on four dimensions that exceeded the level of market-wide governance improvements occurring in the post-SOX era, while firms targeted by whistle-blowers via OSHA (a much less public venue) did not¹²⁵⁵. This suggests the visibility of the allegation played a role in firms' responses to whistleblowing revelations.

Whistle-blowers do make a positive contribution

The analysis presented above is remarkable as being low in theory and high in empirical data. An unbiased view on its results leads to the conclusion that contrary to the anecdotal evidence of shrewd operators among corporate employees manipulating whistleblowing law to their advantage and causing nuisance to their employers, as well as greedy *qui tam* relators undermining integrity of corporate cultures, another picture comes out of the blurred corporate landscape. The companies suffered from whistleblowing exposures did have an

¹²⁵⁵ *Ibid.*

issue – the revelations made by their employees reflected the underlying weaknesses in corporate governance, misdeeds by the companies’ managers, misrepresentation of facts, straightforward fraud or subtler creatively altered performance reporting and lop-sided disclosure.

After whistleblowing events the companies did underperform, thus proving that their previous reports were cooked, and they had performance flaws to be addressed. More importantly, at least formally the companies involved had to focus on improving their corporate governance, and even changed their management. Strategically the temporary loss in shareholders’ value may lead to its further increase after the companies complete necessary reforms, thus offsetting burdensome financial losses incurred on stakeholders.

Whistleblowing and costs of compliance

There is an argument that *qui tam*, and broader, blowing a whistle -- are redundant. The row of fines and settlements involving biggest banks and corporations paying dozens of billions to atone for the misdeeds convincingly demonstrate that the system works perfectly without any private enforcement initiative.

The argument in itself is not without merit. Wishing or not, however, it confuses the cause and sequence, leaving aside the problem of deterrence in its entirety. What is really striking in the latest statistical data in respect of the punitive payments incurred on the world leading banks is that the post crisis legal claims are rising steadily in such a pace that now must be considered a cost of doing business. Indeed, a peer group comprising 6 US banks¹²⁵⁶ and 12

¹²⁵⁶ Bank of America, JPMorgan Chase, Citigroup, Morgan Stanley, Wells Fargo, and Goldman Sachs

European banks¹²⁵⁷ had to put aside over \$260 bln for the period since 2008 as litigation costs. The analysis by Morgan Stanley predicts the group will incur another \$60bn of litigation costs in the next two years¹²⁵⁸. The rise in litigation costs came upon the sum of fines and compensation in the last seven years for breaching a variety of financial regulations had reached a record \$235 bln¹²⁵⁹.

What is taking place is the impressive unwinding the accrued distortions in industry regulations, engendered by the pre-crisis regulatory theories applied by the supervisors, intra-bank risk assessment, discredited compliance mechanisms, motivation systems, and theory and practice of corporate governance which failed to live up to the proclaimed principles. Manipulation of currency and interest rate markets, miss-selling mortgages, money laundering -- the fact that back-offices remarkably failed to impose effective control on their banks' front-offices has brought about huge costs, and it is still counting.

In present circumstances it is in the interests of the corporate sector to adopt and employ new models of internal control. Perhaps, tough and even cruel as a model, but *qui tam* provides corporate sector with an effective in-house system of control. The presence of a knowledgeable industry-wise potential relator at the next desk will have a significant effect on the whole complex of intra-company relations affecting the organisational culture at its deepest roots. One may argue, had the banks such an enforcement mechanism behind their backs, would they have been now paying such heavy price for mistakes of their managers?

¹²⁵⁷ BNP Paribas, Credit Suisse, Deutsche Bank, UBS, HSBC, Barclays, RBS, Rabobank, Lloyds Bank, Standard Chartered, ING, Banco Santander

¹²⁵⁸ Ft.com [online] Available at: <<http://www.ft.com/cms/s/0/c6d01d9a-47dc-11e5-af2f-4d6e0e5eda22.html#ixzz3k1Hlb7P6>> (accessed on 2 August 2015)

¹²⁵⁹ Reuters, 25 May 2015

From the point of view of economic analysis of law, banks used to respond correctly to the pre-crisis regulatory regime, where they got mistaken is at the assessment of its externalities.

Another argument is that the *qui tam* model will mount additional litigation costs on top of the already existing heavy expenses the financial sector has to pay for compliance. Thus, Bank of America is spending \$15bn a year on compliance, while JPMorgan is spending between \$8bn and \$9bn¹²⁶⁰. However, it is not the costs of compliance or costs of litigation that presents the most devious regulatory challenge looming large over the corporate sector in general and banks in particular. It is the mercurial nature of the regulators that hides a strategic problem – its unpredictability. From an economics and law perspective, it is clear that the requests for a regulatory design a society sends to the legislators and the executive resembles tidal waves – low in times of economic boom, and high when it busts.

At the moment there is a societal demand for a regulatory machismo. But soon the public mood may change, and the liberal light touch supervisory regime may come in vogue again. Having now much more close relations between banks and the administration than before the crisis the society as a result may end up with a whimsical over flexible regulatory regime, which can be even more light touch by fact, than at a time of Alan Greenspan in the Federal Reserve.

The taxpayers – the individual and institutional alike – should be interested in some stability of banking supervision to avoid future (ever bigger by default) bail-outs/ bail-ins. The employment of *qui tam* as an independent enforcement mechanism for the purposes of deterrent in case of the probable future liberalisation of regulatory regime strategically may

¹²⁶⁰ Ft.com [online], *supra* note 1074 at 259

be less costly for the society than possible (though, most likely, marginal) increase in corporate costs.

Conclusions

The aim of this research was to contribute to the original knowledge by providing an analysis of the *qui tam* legal concept in its historical evolution in a space of time through twenty five centuries, with main focus on two primary common law jurisdictions – the United Kingdom and USA.

The hypothesis underlying the research is that under certain conditions pursuing goal to better and more efficiently exercise some of its functions the state following qualitative changes in a socio-economic environment may delegate part of its authority to the citizens, and provide them with selectively adopted set of pecuniary and non-pecuniary incentives to accept this authority. This hypothesis has been tried with analysis from the following perspectives: macro level - state regulatory practice, and socio-economic development; corporate level -- cost of compliance, and corporate response; basic level -- personal motives, and risks of actual and potential whistleblowers.

The analysis was carried out by applying law and economics methodological framework in its more pluralistic version devoid from rigidity of the original law and economics perspective. Given context dependent nature of *qui tam*, and its ability to pervasively change legal mandates, the more flexible approach has allowed to subject the concept to a more complex analysis, without compromising basic assumptions of the law and economics perspective.

The research confirmed the foundation assumption that *qui tam* model of law enforcement despite its long historical legacy remains an effective legal mechanism, which combines appeal of big bounties, advantage of a dual plaintiff model with public-private cooperation in enforcement, and a freedom to resort to private litigation to prosecute public offences. Viable and flexible, *qui tam* can:

1. Multiply resources devoted to prosecuting enforcement actions;
2. Shift the costs of regulation off the governmental budgets, and onto the private sector;
3. Take advantage of private (and highly proprietary) information to detect violations;
4. Encourage legal and policy innovation;
5. Send a clear and consistent signal that violations will be prosecuted, providing insurance against the risks that a system of administrative implementation will be subverted or captured or stumbled;
6. Limit the need for direct and visible intervention by the bureaucracy in the economy and society;
7. Facilitate participatory and democratic governance.

By applying a Coasean framework to the government law enforcement and placing it within public-private model the research has confirmed the hypothesis that *qui tam* mechanism multiplies prosecutorial resources. It is widely observed that budgetary limitations are a core and recurring constraint on the administrative state's enforcement capacity. Allowing and encouraging relation and private litigation can bring vastly more resources to bear on enforcement, potentially mobilising private actors and plaintiffs' highly professional attorneys in numbers that contribute to agencies' capacity. Moreover, *qui tam* enforcement

mechanism can actually enhance the efficient use of scarce bureaucratic resources by allowing administrators to focus enforcement efforts on violations that do not provide adequate incentives for private enforcers, while staying assured that those that do will be prosecuted by private litigants.

Post-crisis scarcity of government revenues also highlights the comparative political and economic feasibility of enacting multi-purpose *qui tam* enforcement mechanism as compared to bureaucratic intervention. The lack of adequate tax revenues, or the political costs of raising it, encourages government to achieve public policy goals through private legal process because it shifts the costs of regulation away from the state and on to private parties.

Scarcity of public funds places obvious limits on administrative implementation. As distinguished from funding an executive agency to carry out enforcement activities, *qui tam* enforcement regime is, from the government standpoint, more or less self-funding. Although increasing rates of litigation will lead to some increase in the costs of maintaining the judiciary branch, these costs to be offset by the drop in criminal. Thus, with *qui tam* legislators can provide for deterrent at lesser cost than with administrative implementation.

As this research shows, the *qui tam* mechanism offers an efficient remedy to the problem of administrative drift or capture. The growing body of evidence show the scale of a trap modern state finds itself in – the ever growing size of its executive, trying hard to squeeze itself within the strict budgetary confines; the underpaid judiciary and administrative staff facing the rising fast challenge of information asymmetry limiting their ability to understand the evolution of the business environment and ever changing business practice; the new phenomenon of the so-called “fourth branch” of the government, comprising governmental agencies and ever present contractors, -- all this builds an environment, where a fraud against the government

can be exposed only when two conditions are fulfilled: first, the government has physical and intellectual ability to investigate, and second, the government shows its resolve to pursue the alleged wrongdoing. The practice of the departmental waivers presents a new reality, in which the advanced system of milking the federal and state budgets remains undetected due to its sophistication and benign attitude of the administrative supervisors. In such an environment the prosecutorial discretion bears a risk to evolve into tacit abetment.

Evolving through the last 30 years *qui tam* has little in common with an anachronistic view of it as an act of individual guerrilla fighters challenging big business. In fact, today the growing professionalisation of *qui tam* enforcers has borne to life a new legal profession serving the numerous relators, turning the whole process into more than just rudimentary alternative prosecutorial model. As this research shows, when applied within a longer-term *qui tam*, and wider – whistleblowing – proves to be beneficial to the corporations, contributing to increase in shareholders' value.

The model of public-private enforcement with built-in *qui tam* mechanism developed for the purposes of this research, proved effective ancillary role of *qui tam*, both in terms of optimisation of scarce government resources, and legal innovation. As compared with conservative tendencies that bureaucracy fosters, relators who turn into private litigants and their attorneys are more likely to press for innovations in legal theories and strategies that could expand to be adopted by public enforcers. Freedom from bureaucratic constraint also allows private litigants to mobilise and reallocate their enforcement resources more flexibly and expeditiously than established bureaucratic mechanism.

Qui tam is ambiguous as a form of state intervention. Therefore, it may be preferred to direct administrative intervention by legislators with anti-statist agenda, a significant strand of the

American political tradition, particularly as applied to the Federal government in the United States' federalist system. *Qui tam* as a private enforcement regime may be embraced by such legislators as a way of thwarting the growth of "the State". As compared to constructing and financing bureaucratic regulatory enforcement machinery and endowing it with coercive powers, for example, to investigate, prosecute, adjudicate, and issue orders, an enforcement regime that is founded instead on allowing persons to file on behalf of a state a suit in court may attract broader support. If there are pivotal lawmakers prepared to obstruct enactment of regulatory policy that entails bureaucratic state building, utilising *qui tam* enforcement mechanism may facilitate overcoming such obstructions.

For the above-mentioned reasons *qui tam* presents politically more flexible concept. Its reputation as a powerful tool available at hand to the state prosecutors who fight fraud against the government attracts sympathy among defenders of a big state.

Finally, *qui tam* enforcement mechanism contributes to participatory and democratic self-government. Meaningful access to opportunities to defend interests of a state through independent litigation can amount to a form of active and direct citizen participation in the enterprise of self-government. The fact that bounty is also an important part of that mechanism makes it possibly less attractive for the statist who traditionally prefer altruistic motives of citizens' activism. But generally speaking, any legal concept, which combines safe loyalty to the state interests and earning good money, will be eventually popular.

The form of participation offered by *qui tam* may incorporate individual interests into the governing process that would be rendered impotent by simple majoritarianism. Although majoritarian institutions are often thought emblematic of democracy, such institutions do not

exhaust forms of democratic governance. A democracy must respect the rights of individuals and provide opportunities for expression and participation or establish conditions for rational discourse, and courts may be distinctively suited to contributing these elements to a broader democratic regime.

The research shows that as a conceptual framework of economic analysis of law proves that the flexible *qui tam* public-private enforcement model can bring additional value to the society by serving its strategic long-term interests both in time of crisis and economic expansion.

The fact that in a wake of financial crisis the government has become a more salient stakeholder made the picture more complicated, but also highlighted the value of an independent enforcement mechanism offered by *qui tam*. Combining an appeal of bounties paid for valuable information inaccessible and cognitively challenging for those who are not a party in the narrow circles of highly remunerated professionals, with a right to independently litigate on behalf of a society in the interest of public good *qui tam* enforcement may work as an inherent multi-purpose public-private enforcement model, if devoid of its artificially narrowed focus on fraud against the government. The potential of *qui tam* within this model is significant, and requires further analysis, both in terms of theoretical studies and field research.

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