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Whistle-Blowing for Profit: An Ethical Analysis of the Federal False Claims Act

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ABSTRACT. This paper focuses on the 1986 Amendments to the False Claims Act of 1863, which offers whistle-blowers financial rewards for disclosing fraud committed against the U.S. government. This law provides an opportunity to examine underlying assumptions about the morality of whistle-blowing and to consider the merits of increased reliance on whistle-blowing to protect the public interest. The law seems open to a number of moral objections, most notably that it exerts a morally corrupting influence on whistle-blowers. We answer these objections and argue that the law is not objectionable on these grounds. Since there are no compelling moral objections to the law, it is appropriate and acceptable to judge the law in terms of its economic costs and benefits. We assess the most salient of these and conclude that the benefits outweigh the costs. We suggest that a mechanism similar to the Act should be considered for protecting stockholders' interests in the private sector. We conclude by making several proposals for improving the existing legislation.

KEY WORDS: costs and benefits, ethics, Federal False Claims Act, *qui tam*, whistle-blowing

Introduction

One of the most dramatic and intriguing phenomena in the field of business ethics is whistle-blowing. In a testament to public interest in the phenomenon of whistle-blowing and the impact of whistle-blowers on public welfare, three whistle-blowers graced the cover of *Time* as the magazine's persons of the year in 2002: Sherron Watkins (Enron), Cynthia Cooper (WorldCom), and Coleen Rowley (the FBI – regarding 9/11 terrorist attacks). There are also indications that the public is increasingly looking to whistle-blowing to help stem corporate malfeasance. The Sarbanes-Oxley Act passed in 2002 provides new protections for whistle-blowers (Kaplan, 2002–2003). And the Securities and Exchange Commission has recently proposed regulations that would in certain cases require lawyers to blow the whistle on corporations they serve that engage in securities fraud (Pacelle and Schroeder, 2003).

This paper focuses on the 1986 Amendments to the False Claims Act of 1863, which offers whistle-blowers financial rewards for disclosing fraud committed against the US government. We offer a brief history of the law and its implementation. We present and assess the major moral arguments for and against this law and offer a tentative justification for it. We defend the law against the objection of critics that it is morally corrupting to potential whistle-blowers in that it makes it less likely that whistle-blowers will be morally justified in their actions. This objection rests on the widely held view that having good motives is a necessary condition of one's being morally justified in whistle-blowing. We argue that this view is mistaken – having good motives is not necessary for being morally justified in whistle-blowing. We also defend the law against the related objection that it corrupts or harms peoples' characters and makes people less virtuous – more selfish and mercenary, less altruistic and self-sacrificing. Another criticism of the law we attempt to answer is that it creates incentives for employees to hide fraud until it has reached levels under which their awards for dis-

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closure will be maximized. While we do not see any evidence that this happens often, our recommendation for what an improved law might look like, i.e., one with a cap on awards, would greatly reduce the temptation for whistle-blowers to delay action for added monetary gain. Since there are no serious moral objections to the law in principle, we contend that it should be judged in terms of its *economic* costs and benefits. A rough assessment of the costs and benefits associated with the law indicates that the benefits far outweigh the costs. We suggest that a mechanism similar to the Act should be considered for protecting shareholders' interests in private corporations. We conclude by making several suggestions for improving the existing law.

The False Claims Act and recent amendments

The False Claims Act was originally enacted in 1863, in response to the rampant abuses by defense contractors supplying the government during the Civil War. The Act called on private persons to bring to justice those defrauding the government by bringing "*qui tam*" suits against the perpetrators. "*Qui tam*" is an abbreviation for a Latin phrase, meaning "he who, as well as for the king as for himself, sues in this matter." The use of *qui tam* mechanisms dates back to the Middle Ages. Under the Act, both civil and criminal penalties may be assessed against anyone who is found to have knowingly submitted a false claim to the government. The civil penalty provides for payment of double the amount of damages suffered by the United States as a result of the false claim, plus a $2,000 forfeiture for each claim submitted (U.S. Senate Report 99–345, 1986).

The U.S. Merit Systems Protection Board dates the beginning of whistle-blower protection and rights to the passage of the 1958 Code of Ethics for Government Service which "...exhorted Federal employees to expose corruption...and admonished them to place loyalty to the highest moral principles above loyalty to their departments" (1993: 33). The 1966 Freedom of Information Act gave whistle-blowers (and others) the right to make government documents public, and in 1968 the Supreme Court held in Pickering v. Board of Education that public employees criticizing government action were protected under the First Amendment. The Civil Service Reform Act of 1978 established broad protections for whistle-blowers as one of its merit system principles. It prohibited retaliation against whistle-blowers, and empowered the Merit Systems Protection Board and the Office of the Special Counsel to reverse inappropriate disciplinary actions against whistle-blowers. Many state and local governments adopted similar protections in the years following the Civil Service Reform Act, and whistle-blowing increased significantly. By the early 1990s Congress had enacted more than 25 separate laws protecting whistle-blowing in specific areas of government interest (U.S. Merit Systems Protection Board, 1993: 33–34).

Opening a hearing of the U.S. Senate Judiciary Subcommittee on Administrative Practice and Procedure in September of 1985, Senator Grassley of Iowa introduced an amended version of the False Claims Act as the "primary weapon against fraud" (U.S. Senate, 1985:2). He went on to introduce private citizens who, in his language, were "working for defense contractors, (and) were directed by their very own employers to falsely bill the Treasury. When these individuals tried to expose the practice, they suddenly found themselves unemployed, without a job, out in the street" (U.S. Senate, 1985:2). The amended False Claims Act allows *qui tam* suits brought by the citizen but litigated by the government. The *qui tam* (or relator) may receive up to 30% of any judgment arising from his/her suit, and is afforded protection from retaliation for these actions. These amendments to the legislation became effective with the passage of Public Law 99–562: the "False Claims Amendments Act of 1986."

By 1993, the *National Law Journal* reported that more than 400 False Claims Act cases were under review by the U.S. Department of Justice (DOJ), and that DOJ had joined as plaintiffs in more than 70 cases (Chambers, 1993). Three out-of-court settlements reported in the same article netted the U.S. Treasury $239 million. Two of these were defense contractor fraud cases and a third involved the filing of fraudulent Medicare claims by a health care laboratory. The whistle-blowers netted between 15 and 30% of the settlements, with two of the plaintiffs receiving $7.5 and $13.4 million respectively.

Current data provided by the Justice Department indicate that litigation related to the False Claims Act has recently leveled off after initial dramatic increases (see Table I), although the value of recovered

TABLE I

U.S. recoveries in *qui tam* cases

FY	*qui tam* cases filed	Recoveries in *qui tam* cases U.S. intervened in or otherwise pursued	Recoveries in *qui tam* cases U.S. declined	Total recoveries
1987	32			
1988	60	$355,000	$35,431	$390,431
1989	95	$15,111,719	$0	$15,111,719
1990	82	$40,483,367	$75,000	$40,558,367
1991	90	$69,705,771	$69,500	$69,775,271
1992	119	$134,099,447	$994,456	$135,093,903
1993	132	$171,438,383	$5,978,000	$177,416,383
1994	222	$379,646,074	$1,822,323	$381,468,397
1995	277	$245,463,627	$1,813,200	$247,276,827
1996	364	$124,565,203	$14,033,433	$138,598,636
1997	533	$622,746,381	$7,136,144	$629,882,525
1998	470	$432,813,410	$29,225,385	$462,038,795
1999	482	$454,268,984	$62,509,047	$516,778,031
2000	367	$1,197,911,907	$1,814,847	$1,199,726,754
2001	310	$1,163,857,206	$125,658,963	$1,289,516,169
2002	320	$1,063,152,824	$26,101,582	$1,089,254,406
2003	326	$1,395,344,339	$85,042,086	$1,480,386,425
Total	4281	$7,510,963,642	$362,309,397	$7,873,273,039

damages continues to increase. The number of new cases filed peaked in 1997 at 533 and the value of recoveries that year stood at $630 million. In the most recent fiscal year for which data are available (2003) there were 326 *qui tam* cases filed under the False Claims Act and an all-time high of $1.48 billion in damages were recovered. In the period from 1987 (the first year of experience under the newly amended legislation) until the end of fiscal year 2003, there have been a total of 4,281 cases filed and $7.9 billion in damages recovered. The overwhelming majority (81%) of these cases have involved alleged fraud against the Department of Health and Human Services (2,200), including Medicare and Medicaid fraud and against the Department of Defense (1,277 cases). By the end of fiscal year 2003, relators (those who have brought the cases to the attention of DOJ, i.e., the whistleblowers) received $1.22 billion in awards in cases in which DOJ has intervened and $89 million in cases in which DOJ has declined to intervene. In this period whistle-blower awards have amounted to over $1.3 billion under the False Claims Act, with the award averaging just over $1.65 million in cases in which there has been a recovery.

As an editorial on the False Claims Act suggests, the money involved in these cases is substantial enough to grab the public attention: ''Forget all the money you might make going on television shows like Survivor, the Weakest Link, and Who Wants To Be a Millionaire. You can earn much more fighting for truth, justice, and the American way – and you won't have to eat worms or answer stupid questions'' (Sun-Sentinel August 22, 2001). Thus the False Claims Act constitutes a significant development in the area of whistle-blowing that both allows and requires us to examine some of the underlying assumptions about the moral implications of whistle-blowing.

It should be noted that the government need not pursue cases brought to its attention under the False Claims Act. In fact of the 4,294 cases filed by the end of 2003, DOJ declined to intervene in 2,653 cases (62%); the United States intervened (or the cases were otherwise pursued) in 750 cases, and the remainder (891 cases) are still under investigation. Reflecting the greater burden placed on the relator in cases where DOJ declines to intervene (and the greater reward for assuming it), the relators' awards have averaged 24.6% of the government's total

recovery in such cases compared with 16.2% in cases where the government has intervened as of the end of fiscal year 2003. The dollar amount of government recovery in cases it declines tends to be smaller than in cases it pursues. And despite the relators' higher percentage share, the dollar amount of relators' awards in these cases is also smaller (averaging approximately $582,000 versus $1.9 million in government-pursued cases).

Punishments/sanctions for whistle-blowers: A rationale for the Act

Evidence, both of an anecdotal and a statistical nature, suggests that the act of whistle-blowing continues to pose great risks for employees. Looking at this from a legal perspective, Callahan (1990) and Callahan and Dworkin (2000) find inadequate protection in the law for whistle-blowers in many jurisdictions and in many fields of work. Literature reviewed below suggests that whistle-blowers are often treated very harshly by their employers and potential whistle-blowers have good reasons to fear retaliation by their employers. This fear creates a strong disincentive for whistle-blowing. The False Claims Act creates a counter-incentive for people to engage in whistle-blowing in cases in which their employers are defrauding the Federal Government.

Glazer and Glazer conducted a six year detailed sociological study of 64 whistle-blowers. They found that many employers followed a pattern of "harsh reprisals – from blacklisting, dismissal, or transfer to personal harassment" (1989:7) to punish and discourage whistle-blowing by employees. A similar case study by Westin (1981) of ten whistle-blowers reported that all of them had been penalized to various degrees on the job; only three of the ten were able to achieve some type of restitution. In a larger scale study, Rothschild and Miethe (1999:120) found that each of the following forms of reprisal were reported by two-thirds or more of whistle-blowers: (1) loss of job or forced retirement; (2) negative performance evaluations; (3) criticism or avoidance by co-workers; (4) blacklisting, which impeded employment in their field of work.

Likewise, Jos et al. (1989) found in their survey of whistle-blowers at different levels of government and in the private sector that more than 60% of their respondents reported losing their jobs because of reprisals. Whistle-blowers, they found, often face protracted legal battles waged at personal expense. If whistle-blowers are not forced out of organizations they often suffer job harassment and demotions; physical, psychological, and family problems are also common. In the federal sector these trends have persisted despite the efforts of Congress to protect whistle-blowing through the Merit Systems Protection Board and the Office of Special Counsel. Jos et al. (1989) found that, despite the difficulties they faced, most whistle-blowers believed that they had done the proper thing in "going public" with organizational misdeeds, with 41% reporting outside investigations resulting from their disclosures, and 62% reporting changes in their organizations as a result of going public. The U.S. Merit Systems Protection Board (1993) reported that 50% of employees who observed a perceived illegal or wasteful activity claimed to have reported it in 1992, an increase from 1983 survey figures showing that only 30% of employees reported suspected inappropriate activity. This increase occurred despite the fact that few reports of reprisal are resolved in the favor of the employee (U.S. General Accounting Office, 1992).

On a different note, Dworkin and Near (1997) and Near and Miceli (1996) contend that the perception of retaliation against whistle-blowers is exaggerated. Dworkin and Near (1997) report findings of retaliation against only 38% of whistle-blowers in one study and 19–21% in another study, and Near and Miceli (1996) report an incidence of retaliation against only 6% of a third sample. Still, even given these lower estimates, the potential for personal harm must surely be a factor for anyone considering whistle-blowing, and this potential is relevant to the present analysis. In addition, Near and Miceli (1996) concede that classes of employees not legally protected from retaliation are likely to suffer more frequently from retaliation. Moreover, Miceli and Near (1984) note that fear of retaliation discourages people from whistle-blowing even in cases where they have received assurances of protection.

Challenges to the False Claims Act

Not everyone has been a fan of the False Claims Act. Callahan and Dworkin (1992) cite early concerns

that rewarding whistle-blowers was somehow anti-American and anti-democratic and would lead to a nation of snitches. And the Justice Departments of the Reagan administration and the George H. W. Bush administration were reported to be opposed to remuneration for whistle-blowers on the grounds that whistle-blowers should come forward on principle, not for financial gain (Chambers, 1993). Nevertheless, President Reagan did eventually sign the legislation.

Some critics contend that the False Claims Act creates incentives for employees to hide fraud until it reaches levels under which their ''awards'' for disclosure will be maximized (Schmitt, 1995; *National Law Journal*, 1990). This claim is disputed by attorneys in these cases who argue that the often protracted periods of time taken to bring forward these suits are due to the fact that they are putting together extremely complicated cases against very sophisticated corporations, while trying to protect the plaintiffs against retaliation. In any event the issue of the whistle-blower's motivation is frequently taken into consideration in deciding on awards in False Claims Act cases.

It has also been argued that, by creating an avenue of recourse outside the organization, the False Claims Act discourages employees from attempting to discharge their responsibilities to pursue correction of problems from within organizations (Schmitt, 1995). Corporations have also argued that lawsuits under the False Claims Act are an unconstitutional infringement on the separation of powers and usurping powers granted strictly to the Executive Branch and delegating them to individuals. However, without this law employee protections are more limited. In the nuclear industry for example (see *English v. General Electric Co.*) employees would have to seek redress for reprisal under the federal nuclear regulatory law, which allows only for reinstatement and back wages. English fought successfully for compensatory and punitive damages resulting from her illegal dismissal for reporting fraud. In a 9–0 ruling the Supreme Court ruled in favor of Ms. English.

Another objection to the amended Act is exemplified by criticisms of John Phillips, an attorney who helped research and draft portions of the amendments and who, through his law firm and the nonprofit organization, Taxpayers Against Fraud, was the litigator for many of the largest cases to be brought in the first few years under the Act. Critics of Mr. Phillips include those who believe that the financial arrangements allowed under provisions of the Act he drafted are excessively generous to him and his firm (Chambers, 1993). In cases he successfully litigates not only are he and his firm entitled to attorney fees paid by the defendant, but his non-profit group, Taxpayers Against Fraud, as a co-plaintiff, also is entitled to a share of the plaintiff's recovery of damages. Phillips and the many law firms that have sprung up specializing in this type of litigation have also been criticized for their active solicitation of whistle-blowing cases. Critics worry that this sort of solicitation encourages people, who might otherwise not do so, to bring charges in borderline cases (e.g., where the questioned practices may be the result of a misunderstanding or the result of a different interpretation of federal contracting regulations rather than intentional wrongdoing) in order to secure a share of the recovered damages.

Moral objections to the False Claims Act

Many people both inside and outside the government are uncomfortable with the notion of rewarding whistle-blowers. The reasons for this have not always been clearly articulated, but there are several potential moral objections to the law and the practice of rewarding whistle-blowers that are highlighted and evaluated below.

Objection A. The law has a morally corrupting influence on potential whistle-blowers. It introduces selfish motives for whistle-blowing and thereby undermines the conditions for justifiable whistle-blowing. In classroom discussions students often claim that having appropriate moral motivations is necessary in order to be morally justified (morally right) in whistle-blowing. This perspective on the motivations for whistle-blowing occasionally finds support in the literature including works by Bowie (1982), Boatright (1997), Bowie and Duska (1990), and Grant (2002). Given this, one might object to the False Claims Act on the grounds that it causes many people to engage is morally unjustified whistle-blowing for selfish reasons. We have two replies to this objection:

1. We contend that having the right kind of moral motivation is *not* a necessary condition of one's being morally justified in whistle-blowing. Suppose that my employer is involved in illegal and life-threatening activities. Top management knows about this but is not willing to do anything about it. I blow the whistle on my employer and thereby save many lives. I am not motivated by moral concerns or moral considerations, but rather by malice toward my employer. Surely my whistle-blowing in this situation is morally right (permissible/justifiable). It is possible to perform a right action for bad motives; it is also possible to perform a wrong action for good motives. Common sense distinguishes between: (a) a morally right action, and (b) a praiseworthy act or act that shows the agent to be virtuous. John Stuart Mill distinguishes between judgments about the rightness or wrongness of actions and judgments about the moral worth of people. He writes, ''motive has nothing to do with the morality of the action, but much to do with the worth of the agent'' (1979, p. 18). The kind of case we are imagining here is one in which the act of whistle-blowing is morally right but the person who performs it is not virtuous or praiseworthy.

2. Suppose that we reject the foregoing argument and grant that the law results in an increased number of cases of unjustified (i.e., morally impermissible) whistle-blowing. Even granting this, there also seems to be a countervailing moral benefit of the law–a decrease in the number of cases in which people act wrongly in not blowing the whistle for fear of suffering financial catastrophe. (We are thinking of cases in which people are motivated by serious moral concerns, but are terrified at the prospect of losing their jobs. The financial incentives created by the law are likely to tip the balance of motivation in favor of whistle-blowing in many such cases.)

Objection B. The law corrupts or harms people's moral characters and makes people less virtuous–more selfish and mercenary, less altruistic and self-sacrificing.

Reply. Objection B rests on a mistaken account of the nature of moral character and moral virtues. The financial incentives created by the law are unlikely to affect the deep-seated behavioral dispositions that constitute traits of character and moral virtues and vices. Aristotle holds that actions can not be said to exhibit moral virtues unless they spring from ''firm unchangeable [traits of] character'' (*Nichomachean Ethics*, 1962, 1103a14–1103b25). A single act performed out of character cannot be evidence for the existence of virtue or vice. Moral virtues and vices are deep-seated, relatively unchangeable traits of character that involve dispositions to behave in certain ways. For example, courage is an enduring trait of character that involves the disposition to act in certain ways in the face of danger. Financial incentives may give one an incentive to do right or wrong acts, but external incentives and pressures and temptations are not constitutive of a person's moral character. The sort of pressure and incentives this law creates can elicit actions that are ordinarily regarded as right or wrong, without having any effect on a person's character. The extent to which I am courageous or cowardly is a function of how I am disposed to act in various situations in which I encounter risk or danger. It is a function of my ability to master fear in such situations. Suppose that I am drafted into the army and sent to serve in the front lines. If I desert my post at the first sign of danger we would not say that being drafted into to army has made me a more cowardly person. Rather, we would say that being in the army exposed me to conditions in which cowardly dispositions that I already possessed were actualized.

It must be conceded that external incentives (punishments and rewards) sometimes alter or shape a person's character (see Maitland, 1997 for an excellent discussion of how economic institutions can affect one's character). The punishments and rewards that parents give their children do much to shape the children's characters. But in order to have this effect, the incentives need to operate in a large number of cases–recall Aristotle's dictum that we become virtuous by practice. Thus rewarding a child once for being honest is unlikely to make him or her a more honest person. The incentives provided by the law in question operate far too infrequently to have any appreciable effect on peoples' characters. It is very unlikely that any given person would bring action under the False Claims Act more than once.

In our reply to the objection about the Act's potential to harm and corrupt the moral characters of whistle-blowers, we are assuming the correctness of the common-sense view that human beings possess moral virtues and vices, e.g., honesty and generosity,

and other traits of character. This view has been the subject of serious criticism in recent work (Doris, 2005; Harman, 2000). If we are mistaken in making this assumption (i.e., that there is such a thing as character) then the objection about the harm to the whistle-blower's characters can't even get off the ground. Either way, the objection is not a serious problem for our view.

Objection C. The law will encourage whistle-blowers to blow the whistle on their employers without first reporting the problem internally to appropriate authorities. Potential whistle-blowers may postpone bringing charges in order to allow further damages to accrue so that their share of the recovered damages will be greater. The law thus encourages and rewards wrong behavior. Almost all who write on the ethics of whistle-blowing claim that duties of loyalty to one's employer and co-workers imply that it is wrong to report wrongdoing externally unless one first exhausts internal channels, at least in ordinary cases. (See, for example, Boatright, 1997; Bok, 1980; Bowie, 1982, DeGeorge, 1995; Green, 1994; Larmer, 1992; Velasquez, 1998).

Reply. We agree that delaying the reporting of problems so as to increase one's share of potential damages would be morally wrong. But we think that the Act is unlikely to motivate people to do this very often. Those who are so mercenary and self interested as to delay reporting fraud in order to increase its magnitude (and their share of government fraud recoveries) are not likely to blow the whistle at all without the financial incentives the law provides. The Act creates bad incentives in certain cases, but those who would be moved by these bad incentives probably wouldn't have done the morally right thing in the absence of these incentives. The Act seems likely to help give many people additional incentives to do what is right (blow the whistle). Without the Act, selfish mercenary motives weigh heavily against whistle-blowing. In the cases at issue the law seems more likely to improve matters and improve how people act, rather than make things worse. From a moral point of view it is better that fraud be reported late rather than not reported at all. In addition, judges have the authority to reduce the payouts to whistle-blowers when they think they have acted inappropriately in their reporting of abuses.

Further, any bad incentives the Act creates can be greatly reduced by the changes to the Act that we propose below. We propose that payouts to whistle-blowers be capped at $1.5 million to $2 million. This would greatly reduce the incentive for individuals to delay filing charges in the hope that their share of the government's recovery would be larger. So, even if this objection has some force against the existing Act it is not an objection to the improved version of the Act we propose below.

If there is genuine fraud against the government, then damages have already occurred and restitution is required. It is far more likely for restitution to occur if the fraud is reported to the government rather than if the employee just reported it to his/her employer. In this case it would not be enough for one's employer simply to cease the fraud. Of course, if one's employer is only contemplating fraud there would be no damages, and the False Claims Act would not apply. In such a case reporting the problem internally certainly makes more sense**.** If this type of pre-emptive internal reporting is discouraged by the False Claims Act because people are allowing fraud to take place in the hopes of later blowing the whistle and collecting a reward, that would be a problem. However, there is no evidence that this is occurring.

We concede that successful internal whistle-blowing that leads to corporate self-reporting is morally preferable to external whistle-blowing. However, we note that corporations now have a greater incentive to promote effective internal control of fraudulent activities because of the threat posed by the existence of the False Claims Act. Given the greater financial incentives for whistle-blowing provided by this Act and the costs to corporations of being found guilty of fraud corporations might consider providing some additional financial or other incentives for internal reporting that stops fraud.

Economic costs and benefits of the False Claims Act

Since we found no compelling moral objections to the law in principle, it seems reasonable to consider its merits in terms of its economic costs and benefits. In fact, after the initial debate on the False Claims Act, which focused on whistle-blowers' motives, most of the discussions about the merits of the Act

have centered on the economic consequences of the law – its economic costs and its benefits. In this section, we attempt to make an overall assessment of the economic costs and benefits of the False Claims Act. We are concerned here with "legitimate" costs to society. So, for example, we do not include in our discussions the costs to criminal individuals or firms associated with giving back ill-gotten gains.

Digression and clarification of our moral presuppositions

Moral theory is the subject of enduring controversy and debate. We have not, and cannot (given the scope of the paper), offer a justification for any particular ethical theory and we do not presuppose any particular moral theory, e.g., utilitarianism. We contend that, given the merits of our arguments in answer to the moral objections to the False Claims Act, it is morally acceptable to judge the Act in terms of its economic costs and benefits. Any plausible moral theory takes the promotion of good consequences to be desirable and permissible, other things being equal. However, non-utilitarian moral theories hold that there are certain moral prohibitions such as the prohibition against lying and the prohibition against violating human rights that constrain the promotion of good consequences. Such theories hold that sometimes it is impermissible to do what will have the best consequences. As we have argued above, we find no serious non-utilitarian, non-economic considerations that weigh against The False Claims Act. The Act, in our view, neither violates nor encourages the violation of moral prohibitions. Further, it does not result in any serious non-economic harms such as harm to people's characters. Thus, even if the correct moral theory is non-utilitarian, it is appropriate and morally permissible to assess this Act in terms of its economic costs and benefits.

Benefits in comparison to costs [1]

Substantial work has been done by others in attempts to make assessments of the economic costs and benefits of the False Claims Act, and we will refer to this earlier work. In particular the U.S. government established a national Health Care Fraud and Abuse Control Program (HCFAC) in 1996, which allocates funds to various government agencies that address health care fraud. Additionally, this program issues an annual report. See for example, The Department of Health and Human Services and the Department of Justice Health Care Fraud and Abuse Control Program Annual Report for FY 2002 (available http://www.usdoj.gov/dag/pubdoc/hcfacreport-2002.htm accessed 1/5/05). This report provides both a summary of direct government expenditures and an assessment of progress in reducing health care fraud in the governmental sector. Since health care related claims comprise over 50% of the cases brought and damages recovered under the False Claims Act, these annual reports provide important insights into the overall costs and benefits of the Act. In addition, several studies conducted for the organization Taxpayers Against Fraud (Meyer and Anthony, 2001; Meyer, 2003; and Stringer, n.d.) have utilized these and other governmental statistics and have extrapolated from them to make projections of overall costs and benefits. We recognize that these latter studies are of an advocacy nature (in support and defense of the False Claims Act). So, although we refer to these studies in our analysis we do not rely exclusively on them. Based upon our analysis, and using very cautious and conservative estimates of the relative magnitudes of costs and benefits, we contend that the benefits clearly outweigh the costs. Table II summarizes the results of the cost-benefit analysis that we discuss in this section.

The reader should note that there were some rare False Claims Act cases filed prior to the 1986 amendments to the False Claims Act, approximately one to two dozen, in the decade before passage of this legislation (U.S. Department of Justice, 2004b). Ideally the costs and benefits of these cases should be netted out against the new cases; however, no data on these are available. Nevertheless, there are so few of these cases that they would have only negligible effect on the analysis.

Meyer (2003) uses the period 1997–2001 to make his estimates of governmental costs and benefits related to health care fraud enforcement activities under the False Claims Act. This study found that benefits exceeded costs by a ratio of 8.7–1, not counting the fraud deterrence effect of the law. Meyer suggests that, given the magnitude of the penalties, these deterrence effects are likely to be

TABLE II

Summary of costs and benefits estimates of the *qui tam* provisions of the false claims act.1997–2001

Benefits		Costs	
B1 Recovered Damages	$3.69 billion	C1 False Charges	$792 million
B2 Protecting/Compensating Whistle-blowers	$680 million	C2 Prosecution of Legitimate Claims	$547.3 million
B3 Deterrence of Fraud	$22.4 billion to $93.3 billion	C2a Governmental Costs of Prosecution	$310.3 million
		C2b Whistle-blower payments to law firms	$227 million
		C3 Other organizational costs	Insignificant
		C4 Delayed Whistle-Blowing	Insignificant
Total	$26.8 billion to $97.7 billion		$1.88 billion
Ratio of benefits to costs	14/1 to 52/1 33/1 (mean)		

several times the magnitude of the direct measurable benefits of the law. We use this same time period and make adjustments to this analysis to account for the fact that we are interested in all fraud recovery activities covered under the *qui tam* provisions of the False Claims Act. Our estimates differ from Meyer's analysis in that: (1) we include the costs of enforcement activities and government recoveries under the False Claims Act only for *qui-tam* (or whistle-blower) cases. In addition to these, Meyer also included non *qui tam* cases or assertive actions of the government not initiated by whistle-blowers; (2) we include governmental fraud enforcement activities and recoveries covered under the False Claims Act in all categories of fraud, not just health-care related fraud, which Meyer estimates at about 65% of the total; (3) we include an estimate of the costs of groundless claims; (4) we include an estimate of the costs of legal fees of the whistle-blowers; and (5) we take a societal rather than a governmental perspective on costs and benefits. Thus we count payments to whistle-blowers who make legitimate complaints as societal benefits, whereas Meyer only counts benefits to the government.

C1: False Charges (Intentional and Unintentional). These harm employers and impose costs on society at large, which must endure crowded courts and the public cost of litigation as well as those legal and administrative costs of employers, and costs related to adverse publicity, all of which will likely be passed on to consumers and others. These costs can't be equated with the costs of all unjust or wrongful accusations that have occurred since the law went into effect. Rather, they are the costs of those unjust or wrongful accusations that have been raised but that would not have been brought were it not for the law.

Although critics of the False Claims Act assert that this is a significant cost of the legislation, we see this as highly unlikely due to the existing legal mechanisms available to control for this. Whistle-blowers who come forth need to provide very specific information along the lines of "Who? What? When? Where? and How?" of the alleged fraud. Fabricating such details would be difficult and they would need to convince the court that these fabrications were in fact true before they could collect any money. This would be a risky undertaking in light of the punishments and sanctions that often befall whistle-blowers and the legal risks of engaging in perjury. And it is noteworthy that, although the government has a requirement of diligence to *consider* all accusations brought under the False Claims Act, it need not act on all such accusations. If it believes the accusations to be groundless or the evidence to be too weak it can simply decide not to pursue the case to trial. (The whistle-blower does have the option under the *qui tam* provisions of the law to pursue the case independently but he/she – or the whistle-blower's lawyer under a contingent fee arrangement–would bear the cost of an unsuccessful suit.) The government's interest in not pursuing weak or

groundless claims, as well as the costs to the whistle-blower and his/her attorney of doing so on their own, should have the effect of greatly limiting the costs of false charges. In fact the data cited above indicate that the government has been quite selective in deciding which cases to pursue. Undoubtedly there are some cases of disgruntled or greedy employees intentionally filing false charges. But on balance, the law gives no incentive to whistle-blowers to file false charges and the law gives whistle-blowers no protection from lawsuits or prosecution arising from false charges brought for the purpose of harassment (Public Law 99–562—Oct. 27, 1986).

Still, there are those who have claimed that the costs associated with false claims can be substantial. According to Yang and France (1987), quoting Justice Department sources, only about 11% of the cases brought under the False Claims Act had produced a recovery. The implication by Yang and France is that the other cases may have been meritless. In the same article a lawyer who defends companies who have been accused under the Act (and who is an obvious opponent of the law) is quoted as claiming that even a groundless claim can cost the company accused as much as $400,000 (Yang and France, 1987).

There has clearly been an increase in the number of suits brought under the False Claims Act. And it is probably also true that the number of *groundless* claims has increased. As noted, the Department of Justice has declined to intervene in many (62%) of the cases brought to its attention under the False Claims Act. This does not, however, mean that all of these cases were groundless. DOJ may decline to intervene for other reasons (e.g., the purported damages might not be of sufficiently large magnitude; other cases might have a higher likelihood of success; or there might be other public policy considerations regarding which cases to pursue). Still, about 82% (2,184 of 2,653) of the cases in which the Department of Justice has declined to intervene have been dismissed by the courts with no recovery. Less than 4% (27 of 750) of the cases in which DOJ has intervened have been dismissed without a recovery. And, because these are often complicated cases that take years to investigate and litigate, many (347 as of September 30, 2003) of the cases that have not produced a recovery are still active or under investigation. Reflecting this time lag, the percentage of cases producing a recovery has risen (according to the most recent data available) to 18% since Yang and France wrote their article.

Assuming that all 2,211 (2,184 + 27) dismissed False Claims cases were groundless and also assuming reasonable accuracy of Yang and France's estimate of $400,000 for a corporation to defend itself in such a case, we calculate a total cost of $884 million ($1.33 billion, adjusting for inflation). For the time period 1997–2001, we estimate these costs at $792 million. We believe this estimate is very cautious in terms of our overall cost-benefit analysis given that it is based on the assumption that *all* dismissed False Claims cases were groundless. Thus, this mostly likely overstates the cost of groundless claims.

As noted, there would also be costs associated with the bad publicity of false charges. We do not have any way to calculate the magnitude of these costs but we do not think they should be significant in most cases. Many such false charges are likely to be judged groundless by the Justice Department. This is a point that firms would undoubtedly emphasize in response to any bad publicity.

C2: Costs of prosecutions and defense of legitimate claims. The Fraud Section of the U.S. Department of Justice Civil Division, Commercial Litigation Branch prosecutes cases in conjunction with U.S. Attorneys offices around the country under the False Claims Act. And, as noted, individuals may bring charges under the *qui tam* provisions of the Act and they too will incur costs. We don't include the legal costs to companies in cases in which they defend themselves against legitimate complaints. If a corporation is guilty of fraud or other serious misconduct, which has cost the government money, then it should agree to compensate the government and not fight the charges in court. Legal expenses incurred in an attempt to avoid paying what it owes the government should not be counted as ''costs'' of the Act.

The HCFAC Annual report provides data on government expenditures to curb health care fraud. Even though these are not precise, they do provide a good idea of the general order of magnitude. And because health care cases represent over 50% of the *qui tam* cases, we can extrapolate from these costs to total costs for the prosecution of *qui tam* cases. Meyer

(2003) estimates the total costs of governmental health care fraud enforcement efforts for the 1997–2001 time period at $315.2 million. During the 1997–2001 period approximately 65% of governmental civil fraud recoveries were from health care cases. So, extrapolating from this and factoring out the government enforcement activities related to the (approximately 20%) non *qui tam* cases, we arrive at a total of $310.3 million.

Whistle-blowers will also bear many costs associated with filing of charges under the False Claims Act. The burdens imposed on the whistle-blower and the effort to compensate for them are, of course, the principle rationales for the monetary awards provided to individuals under the False Claims Act. However, we are only concerned here with the additional costs they bear that are associated with the False Claims Act. The chief financial costs are likely to be litigation costs associated with charges that whistle-blowers would not otherwise have filed. However, given industry practice, most of these are not out-of-pocket costs for the whistle-blowers. They are likely to be borne by the law firms that take False Claims cases on a contingent fee basis. Reflecting standard industry practice, we estimate that payments to law firms representing False Claim Act whistle-blowers is about 1/3 of the whistle-blowers' recoveries under the False Claims Act. For the period 1997–2001, we estimate total whistle-blower recoveries under the False Claims Act at $680 million and we estimate their legal fees at 1/3 of this or $227 million. Thus we estimate the total costs of prosecution of these *qui tam* cases in the 1997–2001 period at $547.3 million ($310.3 million + $227 million). We do not include a cost of corporate defense in cases in which there are legitimate claims since, as noted, we are only concerned with legitimate costs and benefits.

It should also be noted that the False Claims Act provides additional protections for whistle-blowers, thereby reducing some costs that whistle-blowers might incur without the existence of this legislation.

C3: Other Organizational Costs. Erosion of morale and trust occurs within organizations caused by the fear of whistle-blowing and attendant losses of efficiency as individuals attempt to protect themselves from potential legal action by fellow employees. Although these are difficult to measure, we do not believe these costs are likely to be significant in most cases. In general, those who aren't committing or condoning fraud needn't worry. And the costs of actions taken to prevent fraud from occurring should be more than offset by the benefits of the reduced fraud. Still, the impact of the False Claims Act on trust and cooperation in organizations would be an interesting phenomenon to explore and attempt to measure, but it is beyond the scope of this paper.

C4: Delayed Whistle-blowing. Potential whistle-blowers may postpone bringing charges in order to allow further damages to accrue so that their share of the recovered damages will be greater, but we contend that this is unlikely to be a substantial cost. Those who are so mercenary as to delay reporting fraud in order to increase its magnitude (and their share of government fraud recoveries) are not likely to blow the whistle at all without the financial incentive the law provides. In such cases, the law still improves matters. It is better that fraud be reported late rather than not reported at all. The harm the government suffers when whistle-blowers delay reporting is financial harm that can be compensated for at a later date. It would be a different matter altogether if we were considering cases in which people delay reporting safety hazards and people die or are injured as a result. And the courts have the discretion, as they have demonstrated, to reduce the award to a whistle-blower who they believe has acted against the public interest in an attempt to increase his/her own award.

B1: Recovered Damages from Fraud. More fraud against the government will be caught and punished. The government will be repaid and taxpayers will benefit. The U.S. government has already received approximately $6.6 billion ($7.9 billion in recovered damages minus approximately $1.3 billion paid out to the whistle-blowers) under the *qui tam* provisions of this law during the period from fiscal years 1987 through 2003 (U.S. Department of Justice, 2004a, Unpublished data). However, this entire amount can't be counted as a benefit of the law – the benefit to society is that portion of the $6.6 billion that wouldn't have been returned to the government were it not for the law.

The benefits come from cases in which whistle-blowers would not have come forward in the absence of the law. This would include cases in which people see problems but are afraid to report them for fear of retaliation. We don't need to suppose base motives on the part of the potential whistle-blower in such cases, just fear. The incentives created by the law can sometimes tip the balance of motivation in favor of blowing the whistle. As noted, the relators' awards in cases where there has been a recovery by the government, including both cases in which the U.S. intervened and those in which it declined to intervene have averaged around $1.65 million. The dramatic increase in the number of whistle-blowing cases under the False Claims Act in the immediate aftermath of the 1986 amendments (see Table I) suggest that the overwhelming majority of the increase is due to the financial incentives created by this legislation. We conservatively estimate that 90% of the money recovered by the government under the *qui tam* provisions of the False Claims Act resulted from the rewards offered under the Act. For the period 1997–2001 there were $4.1 billion in recovered damages from *qui tam* cases, and 90% of this is $3.69 billion.

B2: Protecting Whistle-blowers. These payments will offset some of the costs of whistle-blowing. This benefit can be considerable even if it makes a difference in a relatively small number of cases. The law compensates whistle-blowers for damages incurred and provides a reward for risk taking, and it also has provisions for protecting employees from retaliation. Employees who can prove that they have been terminated or otherwise penalized for whistle-blowing are entitled to reinstatement and up to two times the amount of back pay, plus interest. As noted earlier there is disagreement in the literature regarding the frequency with which whistle-blowers are fired or punished. But even if most whistle-blowers are not fired or punished, there are still many cases in which whistle-blowers are fired or punished. In addition, whistle-blowers in specialized industries with relatively few employers (e.g. nuclear power or aviation) can find themselves unemployable in their chosen professions. In addition to the financial considerations, many report physical, psychological, and family-related problems resulting from their actions (Jos et al., 1989). Thus the harm alleviated by the new law is still considerable.

Clearly some whistle-blowers under the False Claims Act have reaped rewards far in excess of any damages they incurred. Chester Walsh who blew the whistle against General Electric for defense contracting fraud received a payout in excess of $13 million (Chambers, 1993). Gwendolyn Cavanaugh and Virginia Lanford split $8.2 million as a reward for reporting Medicare fraud by their employer, Vencor, a healthcare company (Testerman, 2001). Payouts such as this are common enough to catch people's attention. We use the $1.3 billion received by relators under the Act as a conservative estimate of the financial protection/compensation afforded whistle-blowers by this act. For the period 1997–2001 we estimate that whistle-blowers received $680 million for their share of recoveries.

B3: Deterrence of Fraud. There will be fewer cases of fraud against the government, resulting in savings to the government and taxpayers. Contractors will be more honest because they will be afraid employees may turn them in if they defraud the government.

This seems for us to be the most significant benefit of the new law, as there is evidence that a considerable amount of fraud is committed against the federal government. It is reasonable to expect that perpetrators of fraud are more likely to curb abuses on their own as a result of the False Claims Act because of fear of being reported to authorities by their own employees. In fact our criminal justice system relies on deterrence of all sorts of criminal activities, from tax evasion to motor vehicle violations, because it is not possible for authorities to monitor everyone's behavior.

Assessing the total amount of fraud committed is problematic. Those who commit fraud attempt to avoid detection and we only have accurate figures on those who get caught. Still, we know that there is a lot of fraud that has been detected, and based upon this fact various estimates have been developed on the total amount of fraud that exists.

Stringer (n.d.) in a study conducted for the organization Taxpayers Against Fraud cites U.S. Office of Management and Budget estimates of total fraud against the U.S. government at $81.8 billion for 1997 and rising to $97.8 billion by 2001. Using these figures, Stringer derived an estimate of the fraud-deterrence effect of the *qui tam* provisions of the False Claims Act of between

$105.1 billion and $210.1 billion in the 1997–2006 time period. Building upon this, we estimate that the fraud-deterrence effect would be $46.7 billion to $93.3 billion for the period 1997–2001.

Looking at this from another perspective, if the *qui tam* provisions of the False Claims Act reduced fraud against the government by just 5%, a figure that we think is extremely conservative and quite reasonable given the publicity about high whistle-blower payouts, then there would be a $22.4 billion fraud deterrence effect in the 1997–2001 period. This is based on the Office of Management and Budget estimates of total fraud in this period. Thus, combining these two estimates produces a range of $22.4 billion to $93.3 billion for the fraud-deterrence effect for the 1997–2001 time period.

Summary and conclusion

Using what we believe are reasonable and very conservative assumptions, we have been able to identify costs of roughly $1.88 billion and benefits of between $26.8 billion and $97.7 billion for the period 1997–2001 related to the *qui tam* provisions of the False Claims Act. This suggests that economic benefits outweigh economic costs by a multiple of between 14 to 1 and 52 to 1. We use the mean of this range – 33 to 1 – as our ''best guess'' approximation. While there are costs associated with the operation of the False Claims Act that may be substantial, particularly in cases of false allegations, evidence suggests that these costs are more than offset by the benefits, particularly the recovered damages and the deterrence of fraud. There are no other compelling moral objections to the law. We are not claiming that all laws and social policies should be assessed solely in terms of economic costs and benefits. Rather, we claim that, given the absence of any decisive moral objections to this law or any non-economic considerations of overriding importance, it is reasonable to decide whether the law is desirable in terms of its economic costs and benefits.

Whistle-blowers who today choose the traditional route of external disclosure continue to face the prospect of harassment, demotion, firing, and black-balling within industries, and significant emotional harm to themselves and their families. The False Claims Amendments Act appears to be a remarkable remedy to this problem for those whistle-blowing cases involving fraud against the U.S. government. Although news reports indicated some plaintiffs under the Act suffered, at least temporarily, serious financial harm as a result of their disclosures (Schmitt, 1995), the Act presents them with a way to not only recover these losses but also to receive some compensation for their suffering and their efforts in blowing the whistle.

Many of the theoretical discussions and studies about whistle-blowers date to the early to late 1980's. This paper suggests that the enactment of the amendments to the False Claims Act, and the subsequent flood of cases filed under the Act, is cause for researchers to further discuss the purpose, motivations, nature, and consequences of whistle-blowing in this new era.

An extension of the law

Given the effectiveness of this law in the public sector, it makes sense to consider whether a similar arrangement might be workable in the private sector as well. When corporations are defrauded, stockholders suffer financially, and when fraud is discovered and damages recovered, the corporation and shareholders gain. It might make sense then for corporations to give individuals who report and help uncover fraud against them a share of the recovered damages the same way that the federal government rewards a whistle-blower who uncovers fraud committed against it. There is in fact precedent for this in the private sector. Miceli and Near (1994) report that Hughes Tool Company of Houston provides cash awards of up to $10,000 to employees for information leading to the arrest and conviction of individuals who steal from the company. And Miceli and Near (1992) report that other corporations, including General Motors and Bloomingdales, have similar whistle-blowing rewards programs.

Proposals for improving the law

Despite the merits of the False Claims Act and the net benefits it seems to have produced, we believe

there is room for improvement. We think the idea of capping relator awards at some reasonably generous amount (perhaps $1 million to $1.5 million in cases where the government intervenes and $1.5 million to $2 million in cases where it declines to intervene, and indexing this for inflation) would provide adequate compensation for whistle-blowing without making it an alluring temptation to gain windfall rewards. Exceptions to this cap could be made by a judge or jury in rare instances where an individual suffers exceptionally great financial, psychological, or even physical harm. Relator benefits allow more individuals who want to report wrong-doing to do so in good faith without suffering grave harm. At the same time, a cap on the benefits would reduce the incentives for people to come forth with dubious or exaggerated charges in hopes of winning a whistle-blowing bonanza. A cap on relator awards would also have the benefit of greatly reducing the incentive for individuals to delay filing charges in the hope that their share of the government's recovery would be larger. Moreover, the cap would save the government and taxpayers money by avoiding exorbitant payouts to whistle-blowers.

Despite provisions of the laws protecting whistle-blowers from retribution from their employers, reports cited above suggest that acts of retribution continue. Even though the whistle-blowers may benefit substantially in the long-run – these cases typically take years to settle – the whistle-blower and his/her family may suffer significant financial harm in the interim. Moreover, some of this harm may be irreversible (for example, a family may be unable to afford essential medical treatment for a family member or unable to send a child to college). Thus we would recommend not only tightening the safeguards protecting whistle-blowers from retribution, but also we would recommend a mechanism to provide temporary financial safeguards or benefits for whistle-blowers in cases in litigation where a whistle-blower's employer has taken retribution and the whistle-blower's charges are judged to be credible. We think it would be desirable in such cases for a judge to be able to order a company under indictment, but not yet convicted on fraud charges that has fired the whistle-blower, to continue paying wages temporarily to that whistle-blower. Alternatively it might be desirable to provide financially distressed whistle-blowers access to low-interest loans from funds recovered by the government in earlier False Claims Act cases. Such loans would need to be reimbursed upon conclusion of the case, and the amount of temporary wage payments could be taken into account by the judge when deciding on the size of the judgment against the firm.

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Notes

[1] For the sake of brevity and readability we have not included all of the details and assumptions pertaining to the calculations of this cost-benefit analysis. However, these are available to those who are interested from the third author.

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