Fordham Law Review

Volume 83 *Volume 83*
Issue 1 *Volume 83, Issue 1*

Article 7

2014

Agency Costs and the False Claims Act

David Farber
Fordham University School of Law

NOTES

AGENCY COSTS AND THE FALSE CLAIMS ACT

*David Farber**

The False Claims Act represents the U.S. Justice Department's most effective tool in detecting, punishing, and deterring fraud against the government. The effectiveness of the False Claims Act is due in large part to the law's qui tam provisions, which provide a private right of action to whistleblowers who may sue fraudsters on behalf of the government in exchange for a percentage of the recovery. The resulting relationship between the government and whistleblowers has led to increased detection and recoveries from corporate defendants who defraud and abuse government programs.

However, these whistleblower provisions also come with social costs where profit-motivated private enforcers bring frivolous claims and overenforce. Unlike much of the literature to date, this Note uses an agency-cost approach to analyze these qui tam provisions. This approach allows for an exploration of the incentives created by the qui tam provisions, the associated social benefits and costs, and possible reforms that augment these benefits and reduce unnecessary costs. Specifically, this Note argues that clearly defined incentives for whistleblowers and corporate defendants, along with a requirement that settlements be publicly filed and include admissions of wrongdoing, will reduce agency costs involved with private enforcement under the False Claims Act.

* J.D. Candidate, 2015, Fordham University School of Law; B.A., 2009, University of Pennsylvania. I would like to thank Professor Caroline M. Gentile for her insight and guidance with this Note. I am also forever grateful to Scott Duquette for his love, support, and unfailing patience.

INTRODUCTION

In 2004, Sherry Hunt, a veteran of the residential mortgage industry, accepted a position as a vice president at CitiMortgage, the residential mortgage unit of the Wall Street behemoth Citigroup, Inc.[1] Initially, Hunt was in charge of a team responsible for ferreting out fraud and bad investments in CitiMortgage's correspondent lending division, which purchased loans originated and underwritten by third parties.[2] By 2006, Hunt had identified serious defects in the loans CitiMortgage was purchasing, detailing these findings in regular reports to her supervisors.[3] In 2008, when Hunt was transferred to a quality-control group tasked with investigating and reporting fraud in CitiMortgage's Federal Housing Administration (FHA) loan program, she uncovered more defects, including the widespread failure to report fraudulent loans to the government as required by FHA guidelines.[4]

But, when Hunt brought the defects to the attention of her bosses, they buried her findings.[5] On March 22, 2011, Jeffery Polkinghorne, a CitiMortgage executive in charge of loan quality, asked Hunt and a colleague to stay behind after a meeting.[6] Polkinghorne told them that the

1. Bob Ivry, *Blowing the Whistle on Citi*, BLOOMBERG MARKETS, July 2012, at 26, 28.
2. *Id.*
3. *Id.* at 29.
4. *Id.* at 32.
5. *Id.* at 29.
6. *Id.* at 29, 34.

number of loans classified as defective needed to fall, or it would be their "asses on the line."[7] After the alarming meeting, Hunt made the decision to blow the whistle on CitiMortgage.[8] A week later, she disclosed the fraudulent practices, quality control failures, and the pressure from her superiors to change defect ratings to CitiMortgage's human resources department.[9] On August 5, 2011, Hunt filed a whistleblower suit under the False Claims Act (FCA)[10], detailing CitiMortgage's fraudulent practices and demanding compensation on behalf of the government for the resulting losses to the FHA loan program.[11] In January 2012, the Department of Justice (DOJ) joined Hunt's case and CitiMortgage settled shortly thereafter, admitting to wrongdoing and agreeing to pay $158.3 million in a publicly filed settlement.[12] Hunt was paid $31 million, nearly 20 percent of the recovery, as a whistleblower incentive for uncovering the fraud and bringing it to the attention of the government.[13]

Sherry Hunt's experience is emblematic of the increasing importance of the FCA in combating fraud involving government funds. The DOJ has dramatically increased enforcement of this civil antifraud statute in recent years, bringing in more than $5 billion in recoveries in 2012 alone and an ever-increasing share of the total fraud recoveries under both criminal and civil causes of action.[14]

The unique advantage of the FCA lies in the whistleblower provisions that incentivize individuals to alert the government to fraud involving government funds. Under these so-called qui tam[15] provisions, private persons can file cases against defendants on behalf of the government, share in any recoveries, and engage in private enforcement of the law where the government elects not to pursue the case.[16] While the DOJ's direct enforcement of the FCA without the assistance of whistleblowers is not unusual, the overwhelming majority of actions filed under the FCA are qui

---

7. *Id.*
8. *Id.* at 34.
9. *Id.*
10. 31 U.S.C. §§ 3729–33 (2012).
11. *Id.*
12. *Id.*; *see also* Press Release, U.S. Dep't of Justice, Manhattan U.S. Attorney Files and Simultaneously Settles Fraud Lawsuit Against CitiMortgage, Inc. for Reckless Mortgage Lending Practices (Feb. 15, 2012), http://www.justice.gov/usao/nys/pressreleases/February12/citimortgageincsettlement.html.
13. *See* Ivry, *supra* note 1, at 30.
14. *See* Press Release, U.S. Dep't of Justice, Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012 (Dec. 4, 2012), http://www.justice.gov/opa/pr/2012/December/12-ag-1439.html.
15. The term "qui tam" (pronounced "kwI tam" or "kee-tam") comes from the Latin *qui tam pro domino rege quam pro se ipso in hac parte sequitur*—"who as well for the king as for himself sues in this matter." BLACK'S LAW DICTIONARY 1444 (10th ed. 2014) (defining "qui tam action" as "[a]n action brought under a statute that allows a private person to sue for a penalty, part of which the government . . . will receive").
16. The whistleblower provisions of the FCA are found at 31 U.S.C. § 3730(b)–(h) (2012). *See also infra* Part I.A.

tam actions, and the vast majority of recoveries under the FCA are attributable to qui tam cases as well.[17] This Note accordingly focuses primarily on qui tam actions filed by current or former employees of corporate defendants in analyzing the agency costs[18] involved with the enforcement of the FCA's whistleblowing provisions.

Agency cost theory[19] provides a robust analytical framework for examining the advantages and disadvantages of the FCA's statutory scheme. This theory allows for the exploration of the incentives created by the qui tam provisions, the associated social benefits and costs, and the evolutionary changes to the FCA statutory scheme that augment these benefits and reduce unnecessary costs. This Note endeavors to further develop the previously limited analysis of the agency relationships involved in the FCA context.[20]

Part I of this Note provides background on the FCA, including the relevant procedure, historical development, and aspects of qui tam litigation in practice. Part II provides a primer on agency cost theory and its application in the corporate fraud context. Part III analyzes the agency costs associated with qui tam litigation under the FCA and identifies distinct advantages and potential disadvantages of the FCA's private enforcer regime. Finally, in Part IV, this Note proposes several reforms for the FCA from the conclusions derived from the agency cost analysis including the DOJ's adoption of clearly defined incentives for whistleblowers and corporate defendants, along with a requirement that FCA settlements be publicly filed and include admissions of wrongdoing.

---

17. From 2010 through 2013, 2614 qui tam actions were filed compared to 500 non-qui tam suits. *See* U.S. DEP'T OF JUSTICE, FRAUD STATISTICS – OVERVIEW 2 (2013), *available at* http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf. Over the same period, recoveries from qui tam-initiated actions represented \$11.5 billion, while recoveries from non-qui tam actions represented \$3.3 billion. *See id.*

18. Agency costs refer to the monitoring costs, bonding costs, and residual loss incurred in agency relationships. *See infra* Part II.A.

19. *See* Kenneth E. Scott, *Agency Costs and Corporate Governance*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 26 (Peter Newman ed., 1998) ("Agency cost theory deals with the inevitable divergence of self interest between principal and agent, owner and manager, or employer and employee, the welfare losses thereby created, and the devices and institutions that have evolved to reduce those losses.").

20. *See, e.g.*, William E. Kovacic, *Whistleblower Bounty Lawsuits As Monitoring Devices in Government Contracting*, 29 LOY. L.A. L. REV. 1799, 1806–07, 1821 (1996); Robert Howse & Robert J. Daniels, *Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy*, *reprinted in* CORPORATE DECISION-MAKING IN CANADA 525, 543–44 (Ronald J. Daniels & Randall Morck eds., 1995), *available at* http://repository.upenn.edu/law_series/4/ (discussing the FCA framework using an agency theory perspective).

I. BACKGROUND: THE FALSE CLAIMS ACT

The FCA[21] is the federal government's principal antifraud tool, containing whistleblower provisions that allow private individuals to file suit on behalf of the government, alert authorities to fraud affecting taxpayer dollars, and engage in private enforcement of these antifraud causes of action.[22] The enforcement of the FCA follows three principal avenues: (1) direct enforcement by the DOJ; (2) government intervention in qui tam actions; and (3) private enforcement by go-it-alone qui tam relators. This Note is principally concerned with the latter two avenues of FCA qui tam litigation.

This section offers an overview of the FCA qui tam provisions. Part I.A briefly describes the procedure for filing a qui tam action, and Part I.B traces the historical development of the qui tam provisions. Part I.C then outlines the reality of qui tam litigation, discussing the motivations of FCA whistleblowers, the incidence of frivolous suits, and the issues involved with the resolution of FCA litigation.

A. Qui Tam Procedure

Under the qui tam provisions, a whistleblower, referred to as a relator, initiates an action by filing a complaint under seal, on behalf of herself and the federal government, in the relevant federal district court.[23] The relator must also serve the government with a copy of the operative complaint along with a disclosure of all other material facts concerning the allegations.[24] The complaint remains under seal for a minimum of sixty days to allow for the government to investigate the relator's allegations and determine whether to intervene in the case.[25] The FCA provides the DOJ with authority to issue Civil Investigative Demands (commonly referred to as "CIDs")—essentially prelitigation unilateral discovery devices that may compel witness testimony, production of documents, and answers to interrogatories.[26] The government can request extensions of the seal period for good cause,[27] and these seal extensions are often liberally granted.[28] As

21. The precursor to the FCA was first enacted in 1863 during the Civil War. *See* Act of Mar. 2, 1863, ch. 67, 12 Stat. 696. The modern-day FCA is the product of a comprehensive legislative modernization in 1986. *See* False Claims Amendments Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153. For more recent clarifications, see Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, sec. 4, 123 Stat. 1617, 1621–25.

22. 31 U.S.C. § 3730(b)–(h) (2012).

23. *Id.* § 3730(b)(1).

24. *Id.* § 3730(b)(2).

25. *Id.*

26. *See id.* § 3733.

27. *Id.* § 3730(b)(3).

28. *See* Laura Hough, *Finding Equilibrium: Exploring Due Process Violations in the Whistleblower Provisions of the Fraud Enforcement and Recovery Act of 2009*, 19 WM. & MARY BILL RTS. J. 1061, 1074–75 (2011).

a result, FCA qui tam investigations and cases can linger for years before a successful resolution or dismissal.[29]

Under the FCA statute, the government may pursue three courses of action: (1) elect to intervene in the qui tam action and takeover the prosecution of the suit; (2) decline to intervene in the qui tam action and allow the relator to prosecute the suit on behalf of the government; or (3) move to dismiss the qui tam action entirely.[30] The government may also decide to settle with the defendant prior to intervening in the case, usually resulting in the simultaneous filing of an election to intervene and a settlement between the parties.[31] In cases where the government decides to decline intervention, a relator will often voluntarily dismiss or withdraw the qui tam suit.[32]

B. Historical Development

While the FCA finds its origins in the Civil War era, it remained a relatively underutilized antifraud tool through most of the twentieth century.[33] Prior to the 1986 amendments to the FCA, the law included a jurisdictional bar prohibiting qui tam suits based on information already in the possession of the government.[34] In addition, the government's recovery was limited to double the damages sustained by the government, and the relator's award in an intervened qui tam action was capped at 10 percent of the recovery.[35] This statutory framework resulted in underutilization of the FCA whistleblower provisions, with qui tam filings averaging roughly six per year by the mid-1980s.[36] However, the procurement fraud scandals of that same decade spurred Congress to undertake a legislative overhaul of the FCA in 1986,[37] largely responsible for transforming the FCA into the robust antifraud tool it is today.[38] The principal aim of the 1986 amendments was to engender more FCA suits by increasing incentives for

29. Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 129 n.253 (2007).

30. *See* 31 U.S.C. § 3730(b)(4), (c)(2)(A).

31. *See* U.S. DEP'T OF JUSTICE, FALSE CLAIMS ACT CASES: GOVERNMENT INTERVENTION IN QUI TAM (WHISTLEBLOWER) SUITS (n.d.), *available at* http://www.justice.gov/usao/pae/Documents/fcaprocess2.pdf.

32. *Id.*

33. Geoffrey Christopher Rapp, *Four Signal Moments in Whistleblower Law: 1983–2013*, 30 HOFSTRA LAB. & EMP. L.J. 389, 392–94 (2013).

34. S. REP. NO. 99-345, at 12 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5266, 5277.

35. *See* 31 U.S.C. §§ 3729, 3730(c)(1) (1982).

36. *See* Pamela H. Bucy, *Private Justice*, 76 S. CAL. L. REV. 1, 48 (2002).

37. *See* J. Randy Beck, *The False Claims Act and the English Eradication of* Qui Tam *Legislation*, 78 N.C. L. REV. 539, 561 (2000) ("In the early 1980s, the Department of Defense experienced a series of scandals involving excessive prices paid for items procured from defense contractors . . . high-profile exposés by the national media helped to generate pressure for Congress to amend the False Claims Act."); *see also* False Claims Amendments Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153.

38. *See* S. REP. NO. 99-345, at 2–3.

whistleblowers to come forward and file qui tam actions.[39] Congress raised the amount recoverable from defendants under the FCA from double to treble damages[40] and provided for higher percentage-of-recovery qui tam awards—up to 25 percent where the government intervenes and up to 30 percent where the relator proceeds with the action alone.[41] The 1986 amendments also cleared up ambiguities in the statute with respect to the evidentiary burden and elements necessary to plead an FCA cause of action, expanding the ambit of a false or fraudulent claim to a wider range of conduct.[42] The legislation substantially amended certain provisions that had limited the filing of meritorious claims, modifying the jurisdictional bar precluding suits based on information in the government's possession and allowing relators to pursue actions that the government had declined to prosecute.[43] Raising the potential recovery, easing the burden of proving liability, and removing jurisdictional bars to filing suit were designed to encourage the filing of more qui tam actions by relators on behalf of the government.[44]

While primarily designed to encourage whistleblower actions, several provisions in the 1986 amendments addressed the concerns of the DOJ and potential defendants who were wary that the changes would engender a flood of frivolous and parasitic qui tam suits.[45] The 1986 amendments included a fee-shifting provision meant to disincentivize relators from bringing suits that are "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment"[46] and a public disclosure provision, barring jurisdiction for suits based on publicly disclosed information, unless the potential relator was the original, voluntary source of the information to the government.[47] Additionally, the 1986 amendments sought to encourage defendants to self-report fraud to the government through a reduced

---

39. Elletta Sangrey Callahan & Terry Morehead Dworkin, *Do Good and Get Rich: Financial Incentives for Whistleblowing and the False Claims Act*, 37 VILL. L. REV. 273, 305 (1992) ("The 1986 amendments to the FCA increase the likelihood of recovery by a *qui tam* plaintiff in several ways: (a) by guaranteeing minimum amounts to be awarded in successful cases; (b) by making it easier for a plaintiff to make a successful claim; and (c) by potentially expanding the class of persons who may bring claims.").

40. 31 U.S.C. § 3729(a) (1988).

41. *Id.* § 3730(d)(1)–(2).

42. Under the 1986 amendments, the burden of proof was set at a preponderance of the evidence standard. *See id.* § 3731(c). The "knowingly" scienter requirement was defined as acting with a "reckless disregard" to the falsity or fraudulent nature of the claim presented to the government, requiring no specific intent to defraud. *See id.* § 3729(b)(1).

43. S. REP. NO. 99-345, at 29–30.

44. *See* Callahan & Dworkin, *supra* note 39, at 336.

45. S. REP. NO. 99-345, at 14 ("In response to Justice Department concerns, [the 1986 amendments bill], and specifically the *qui tam* provision, was significantly revised . . . .").

46. 31 U.S.C. § 3730(d)(4); *see also* S. REP. NO. 99-345, at 16 ("As a further prevention of frivolous actions, the subcommittee adopted attorneys fees sanctions to be charged against any *qui tam* plaintiff who brings a clearly frivolous or vexatious suit.").

47. These so-called "public disclosure bar" or "original source" provisions were codified at 31 U.S.C. § 3730(e)(4).

damages provision.[48] Under this provision, corporations that self-report fraud face a maximum of double damages (as opposed to treble) and reduced penalties.[49]

Subsequent significant amendments to the FCA came in the aftermath of the subprime mortgage crisis through the Fraud Enforcement and Recovery Act of 2009[50] (FERA). These "clarifications" of the FCA addressed several circuit court opinions that had begun to chip away at the effectiveness of the FCA and had limited otherwise meritorious suits from going forward.[51] Additionally, the 2009 amendments enhanced safeguards for relators, protecting all whistleblowing activity aimed at stopping a violation of the FCA, not just activity in furtherance of a formal qui tam lawsuit.[52] Congress made clear that these provisions ensure whistleblowers are protected from employers' retaliation where they report FCA wrongdoing internally to supervisors or compliance departments.[53]

Certain amendments to the FCA's public disclosure bar provision were also included under the Patient Protection and Affordable Care Act of 2010[54] (PPACA). Under the PPACA, the jurisdictional bar of the public disclosure provision was replaced with a mandatory dismissal provision, subject to opposition by the government.[55] Additionally, the "based upon public disclosure" language was removed and replaced with the phrase "if substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed . . . ."[56] This language tracks the majority view of circuit courts in construing the previous version of the public

---

48. *See id.* § 3729(a)(A)–(C).

49. These provisions remain the same today. *See* 31 U.S.C. § 3729(a)(2) (2012). To qualify under these subsections, the violating party must furnish all information relating to the violation to the government within thirty days of obtaining the information and must fully cooperate with the government investigation. *Id.* § 3729(a)(2)(A)–(B). Furthermore, the government cannot have already initiated a criminal prosecution or a civil or administrative action, and the party cannot have actual knowledge of a current investigation into the violation. *Id.* § 3729(a)(2)(C).

50. Pub. L. No. 111-21, sec. 4, 123 Stat. 1617, 1621–25.

51. *See* S. REP. NO. 111-10, at 10 (2009), *reprinted in* 2009 U.S.C.C.A.N. 430, 438 ("This section amends the FCA to clarify and correct erroneous interpretations of the law that were decided in *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123 (2008), and *United States ex. rel. Totten v. Bombardier Corp*, 380 F.3d 488 (D.C. Cir. 2004).").

52. *See* 31 U.S.C. § 3730(h) (2012).

53. *See* 155 CONG. REC. 12,699 (2009) (statement of Rep. Howard L. Berman) ("This language [of the 2009 amendments] is intended to make clear that this subsection [Section 3730(h)] protects not only steps taken in furtherance of a potential or actual qui tam action, but also steps taken to remedy the misconduct through methods such as internal reporting to a supervisor or company compliance department and refusals to participate in the misconduct that leads to the false claims . . . .").

54. Pub. L. No. 111-148, 124 Stat. 901–02.

55. 31 U.S.C. § 3730(e)(4)(A).

56. *Id.*

disclosure bar,[57] and there are preliminary indications that district courts will follow this established public disclosure jurisprudence.[58] These amendments from the PPACA were prompted by concerns that district courts were unduly limiting qui tam actions and improperly dismissing relators' suits where important information unknown to the government was brought to light.[59]

C. Qui Tam Litigation in Practice

The qui tam cause of action is a unique legal tool, and the practical experience of FCA qui tam litigation is correspondingly a complex and nuanced area of law. Whistleblowers and their counsel often face a wide array of concerns and motivations when contemplating a qui tam filing—factors that may manifest in frivolous filings and overenforcement. Additionally, both relators and defendants are routinely required to grapple with unique considerations involving resolution and settlement of FCA cases.

1. Fear of Meritless Claims

Many have criticized the qui tam provisions for an apparent overabundance of meritless FCA claims.[60] According to DOJ statistics, the government has historically intervened in less than one quarter of filed qui tam cases.[61] In those cases in which the DOJ intervenes, the recoveries are much higher than in non-intervened cases, presumably because the DOJ chooses to intervene in suits that provide a better chance of prevailing and involve greater damages exposure.[62] Some commentators have argued that

---

57. *See* Glaser v. Wound Care Consultants, Inc., 570 F.3d 907, 915 (7th Cir. 2009) ("Under the majority view, a lawsuit is based upon publicly disclosed allegations when the relator's allegations and the publicly disclosed allegations are substantially similar.").

58. *See* United States *ex rel.* Osheroff v. HealthSpring, Inc., 938 F. Supp. 2d 724, 732 n.10 (M.D. Tenn. 2013) ("[P]re-PPACA Sixth Circuit cases are instructive regarding whether an allegation is substantially the same as that found in the public disclosure.").

59. *See* Ni Qian, Note, *Necessary Evils: How to Stop Worrying and Love Qui Tam*, 2013 COLUM. BUS. L. REV. 594, 611–12.

60. *See, e.g.*, *Oversight of the False Claims Act: Hearing Before the Subcomm. on the Constitution and Civil Justice of the H. Comm. on the Judiciary*, 113th Cong. (2014) (statement of David W. Ogden, Partner, Wilmer Cutler Pickering Hale and Dorr LLP, U.S. Chamber Institute for Legal Reform) ("In most . . . [qui tam] cases, the government declines to intervene, typically deeming them unworthy of government lawyers' time."); Christopher M. Alexion, *Open the Door, Not the Floodgates: Controlling* Qui Tam *Litigation Under the False Claims Act*, 69 WASH. & LEE L. REV. 365, 404 (2012) ("Evidence of parasitic qui tam actions is alarming."); Christina Orsini Broderick, Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 COLUM. L. REV. 949, 964 (2007) ("Data on the rates of intervention in false claims actions appear to indicate that the qui tam provision of the FCA leads to a significant number of frivolous suits.").

61. *See* Broderick, *supra* note 60, at 971.

62. *See* Michael Rich, *Prosecutorial Indiscretion: Encouraging the Department of Justice to Rein in Out-Of-Control Qui Tam Litigation Under the Civil False Claims Act*, 76 U. CIN. L. REV. 1233, 1263 (2008).

this low intervention rate lends credence to the claim that a large number of frivolous and nonmeritorious suits are being filed by would-be whistleblowers.[63] However, DOJ statistics regarding nonintervention cannot provide an accurate indicator of nonmeritorious claims for several reasons, including the nature of statistics compiled by the DOJ,[64] limited prosecutorial resources,[65] differing prosecutorial priorities,[66] and the instance of cases with low potential monetary recoveries.[67] Additionally, in cases where the DOJ has decided against intervention, it may reserve the right to intervene for good cause at a later point in the litigation.[68] Indeed, the DOJ routinely investigates and remains involved in non-intervened cases where it still believes that the case has potential merit.[69] The DOJ also monitors and remains active in the litigation of non-intervened cases where the development of FCA precedent or other interests of the government may be substantially affected.[70]

While the government's intervention decision alone may not be an accurate indicator of meritorious claims, the high dismissal rate of these non-intervened cases appears to buttress the claims that opportunistic relators file a large number of frivolous or nonmeritorious suits. The government declines to intervene in the majority of qui tam filings, and 94 percent of these non-intervened cases where it did not intervene are later dismissed.[71] While the dismissal rate of non-intervened suits should be

---

63. *See* Callahan & Dworkin, *supra* note 39, at 325–26; *see also* Broderick, *supra* note 60, at 971. Although beyond the scope of this Note, it is important to note that nonmeritorious claims may still provide net social benefits. *See generally* Alexander A. Reinert, *Screening Out Innovation: The Merits of Meritless Litigation*, 89 IND. L.J. 1191, 1225–30 (2014).

64. *See* JAMES B. HELMER, JR., FALSE CLAIMS ACT: WHISTLEBLOWER LITIGATION 1079–80 (6th ed. 2012).

65. *See* United States *ex rel.* Chandler v. Cook Cnty., 277 F.3d 969, 974 n.5 (7th Cir. 2002) ("There is no reason to presume that a decision by the Justice Department not to assume control of the suit is a commentary on its merits. The Justice Department may have myriad reasons for permitting the private suit to go forward including limited prosecutorial resources and confidence in the relator's attorney.").

66. *See* United States *ex rel.* Killingsworth v. Northrop Corp., 25 F.3d 715, 720 (9th Cir. 1994) ("The government argues it delayed intervening at the district court level because it sought to avoid the burdens of a litigant, such as discovery, and because of possible *res judicata* effects.").

67. *See* Qian, *supra* note 59, at 603. Where a filed qui tam action involves a low potential monetary recovery but a high likelihood of successful prosecution, it is sensible for the DOJ to conserve government resources and allow relators to pursue the action without intervention. *See* Rich, *supra* note 62, at 1266–67.

68. 31 U.S.C. § 3730(c)(3) (2012).

69. *See* Letter from Jim Esquea, Asst. Sec., U.S. Dep't of Health & Human Servs., and Ronald Weich, Asst. Att'y Gen., U.S. Dep't of Justice, to Sen. Charles E. Grassley 13 (Jan. 24, 2011), *available at* http://www.taf.org/DOJ-HHS-joint-letter-to-Grassley.pdf.

70. The DOJ may elect to file statements of interest on important matters during the litigation of these cases despite its decision not to intervene. *See, e.g.*, United States *ex rel.* McMullen v. Ascension Health, No. 12 Civ. 00501, 2013 WL 6073549, at *1 (M.D. Tenn. Nov. 18, 2013); United States *ex rel.* Fox Rx, Inc. v. Omnicare, Inc., No. 11 Civ. 00962 (WSD), 2012 WL 8020674, at *4 (N.D. Ga. Aug. 29, 2012).

71. *See* Rich, *supra* note 62, at 1236.

viewed in the context of the limited resources of the relators' bar[72] and the sometimes onerous pleading requirements under Rule 9(b) of the Federal Rules of Civil Procedure,[73] it is clear that a large number of qui tam suits are filed and later dismissed—supporting an inference that many of these lawsuits lack merit. The filing of many nonmeritorious claims would certainly represent a strain on the resources of attorneys at the DOJ, who are required by statute to investigate qui tam complaints.[74]

The FCA does contain provisions designed to limit frivolous claims—i.e., the threat of dismissal of suits by the DOJ and fee-shifting provisions[75]—however, these provisions are often underutilized. The DOJ has been reluctant to exercise its statutory power to dismiss relators' suits, even where these suits are based on a relator's incorrect liability determination.[76] Additionally, the courts have invoked the fee-shifting provisions for frivolous suits only in rare cases.[77] Moreover, relators faced with potential sanctions for bringing frivolous suits may generally withdraw claims under Rule 11 of the Federal Rules of Civil Procedure without sanction.[78] Accordingly, these provisions probably do not deter many relators from filing nonmeritorious complaints.

2. Profit Maximization and Overenforcement

Similar to fears involving meritless cases, commentators argue that the qui tam private right of action leads to overenforcement of the FCA.[79]

---

72. DOJ intervention in a qui tam action brings to bear the considerable resources of the government in prosecuting a suit and extracting a settlement from a defendant firm. A relator faced with the prospect of litigating a meritorious action without the support of the government may determine that the potential costs (including burdensome discovery) outweigh the benefits and abandon their suit. *See* Callahan & Dworkin, *supra* note 39, at 325–26.

73. In several circuits, the pleading requirements of Rule 9(b) limit many potentially meritorious lawsuits based on the lack of specificity regarding the presentment or payment of claims—evidence usually wholly within the possession of defendants or the government (and unobtainable by subpoena at the pleading stage of litigation). *See generally* Aaron Rubin, *To Present Bills or Not to Present? An In-Depth Analysis of the Burden of Pleading in Qui Tam Suits*, 8 SETON HALL CIR. REV. 467 (2012).

74. *See* Rich, *supra* note 62, at 1247.

75. *See supra* note 46 and accompanying text.

76. *See* Rich, *supra* note 62, at 1264–65 ("[T]he government does not dismiss, and relators are permitted to proceed with, thousands of non-meritorious *qui tam* suits.").

77. Most courts decline to award fees to FCA defendants, noting that "the award of fees under the false claims act is reserved for rare and special circumstances." United States *ex rel.* Rafizadeh v. Cont'l Common, Inc., 553 F.3d 869, 875 (5th Cir. 2008) (quoting Pfingston v. Ronan Eng'g Co., 284 F.3d 999, 1006–07 (9th Cir. 2002)).

78. Todd B. Castleton, *Compounding Fraud: The Costs of Acquiring Relator Information Under the False Claims Act and the 1993 Amendments to Federal Rules of Civil Procedure*, 4 GEO. MASON L. REV. 327, 351 (1996).

79. *See* Dayna Bowen Matthew, *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud*, 40 U. MICH. J.L. REFORM 281, 337 (2007) ("Overenforcement by zealous 'private attorneys general' has been a concern for decades. The seminal literature on joint public-private enforcement abounds with examples.").

Indeed, many argue that "qui tam relators are . . . motivated primarily by prospects of monetary reward rather than the public good."[80] As a result, this typical relator will be opportunistic, "pursu[ing] actions aggressively, even where the actual harm caused by the defendant's conduct is low or the societal harm resulting from the prosecution would outweigh the potential recovery."[81] According to this model, "a relator will proceed with her suit only if the potential recovery, discounted by the chance of losing, outweighs the perceived costs."[82] It is clear that increased whistleblower awards under the FCA have led to an ever-increasing number of qui tam actions.[83]

However, the conception of relators as profit-motivated litigants disregards the complexity of whistleblower decision making, which may often be divorced from economic or monetary incentives.[84] Whistleblowers who file qui tam actions come from varying backgrounds and are often driven by a complex set of motivations. A relator often does not simply weigh the economic gains from filing suit against the potential economic losses—a number of motivations may be involved in the decision to engage in whistleblowing, including altruistic or ethical concerns, a desire to exact revenge on a former employer, or simply the desire to be heard.[85] Indeed, many relators state that initially they did not intend to utilize the qui tam provisions when making their decision to blow the whistle, with many claiming that the financial reward offered under the FCA did not motivate their decision to become whistleblowers.[86] Furthermore, internal

80. Joan H. Krause, *"Promises to Keep": Health Care Providers and the Civil False Claims Act*, 23 CARDOZO L. REV. 1363, 1414 (2002) (quoting Hughes Aircraft Co. v. United States *ex rel.* Schumer, 520 U.S. 939, 949 (1997)).

81. *See* Rich, *supra* note 62, at 1253; *see also* Beck, *supra* note 37, at 622 ("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. The issues relevant to an informer's pursuit of forfeitures are: (1) the likelihood that the informer could convince a court that the defendant violated a statute; and (2) the ability of the defendant to pay the resulting penalty. This focus on wealth maximization tends to exclude competing considerations.").

82. Rich, *supra* note 62, at 1266.

83. *See* Press Release, U.S. Dep't of Justice, Justice Department Recovers $3.8 Billion from False Claims Act Cases in Fiscal Year 2013 (Dec. 20, 2013), http://www.justice.gov/opa/pr/2013/December/13-civ-1352.html ("The number of *qui tam* suits filed in fiscal year 2013 soared to 752—100 more than the record set the previous fiscal year.").

84. *See* Geoffrey Christopher Rapp, *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, 2012 BYU L. REV. 73, 110.

85. *See id.*

86. *See, e.g.*, ETHICS RES. CTR., NATIONAL BUSINESS ETHICS SURVEY 34 (2014), *available at* http://www.ethics.org/downloads/2013NBESFinalWeb.pdf ("Of those who turned outside the company and/or to the federal government with concerns about misconduct, only 14 percent said they were motivated by possible bounty payments—the lowest number among ten choices in the survey."); Aaron S. Kesselheim, David M. Studdert & Michelle M. Mello, *Whistle-Blowers' Experiences in Fraud Litigation Against Pharmaceutical Companies*, 362 NEW ENG. J. MED. 1832, 1834 (2010). Of course, these

whistleblowers (employees within a corporation) and external whistleblowers (nonemployee outsiders) each face a different calculus when blowing the whistle.[87] As such, financial incentives targeted at limiting internal whistleblowers may lead to underenforcement and the reduction of meritorious claims by external whistleblowers.[88] The wide variety of intrinsic and extrinsic motivating factors makes the fine-tuning of whistleblowing incentives a difficult task.[89]

3. The Relator's Share

An important aspect of qui tam litigation involves the settlement or resolution of FCA actions and the determination of the relator's percentage of recovery, commonly referred to as the relator's share.[90] The DOJ published internal guidelines in 1996, providing guidance to DOJ attorneys for determining a relator's percentage share of a given FCA settlement recovery.[91] The DOJ's Relator's Share Guidelines have also been used by several courts in determining a relator's share in cases that result in trial verdicts and judgments or in cases where the government and relator cannot agree on an appropriate percentage share.[92] The guidelines identify two sets of factors to consider in setting the percentage share, "one set counseling in favor of a larger relator's share" where certain criteria are met and one set that would reduce the relator's share where relators do not meet expectations.[93] While apparently useful in some respects, the guidelines have also been derided as containing inconsistencies and "noticeably unhelpful."[94] Because the various factors outlined in the guidelines lack

---

relator accounts could be attributable, in part, to "a socially desirable response bias." *Id.* at 1839.

87. *See* David Freeman Engstrom, *Harnessing the Private Attorney General: Evidence From Qui Tam Litigation*, 122 COLUM. L. REV. 1244, 1295 (2012).

88. *Id.*

89. *See generally* Naseem Faqihi, Note, *Choosing Which Rule to Break First: An In-House Attorney Whistleblower's Choices After Discovering a Possible Federal Securities Law Violation*, 82 FORDHAM L. REV. 3341, 3348–51 (2014).

90. *See* Joel D. Hesch, *Breaking the Siege: Restoring Equity and Statutory Intent to the Process of Determining* Qui Tam *Relator Awards Under the False Claims Act*, 29 T.M. COOLEY L. REV. 217, 223 (2012).

91. *See* U.S. DEP'T OF JUSTICE, RELATOR'S SHARE GUIDELINES (1996), *reprinted in* JAMES B. HELMER, JR., FALSE CLAIMS ACT: WHISTLEBLOWER LITIGATION app. 13.A., at 1342–44 (6th ed. 2012) [hereinafter RELATOR'S SHARE GUIDELINES]; *see also* United States *ex rel.* Alderson v. Quorum Health Grp., Inc., 171 F. Supp. 2d 1323, 1333 (M.D. Fla. 2001) ("The DOJ maintains a set of internal 'Relator's Share Guidelines,' which offer assistance to DOJ attorneys '[w]hen trying to reach agreement with a relator as to his share of the proceeds, or proposing an amount or percentage to a court . . . .'") (citation omitted).

92. *See, e.g.*, United States *ex rel.* Shea v. Verizon Commc'ns, Inc., 844 F. Supp. 2d 78, 83–84 (D.D.C. 2012); United States *ex rel.* Johnson v. Universal Health Servs., Inc., 889 F. Supp. 2d 791, 796–97 (W.D. Va. 2012).

93. *See Universal Health Servs., Inc.*, 889 F. Supp. 2d at 796.

94. United States *ex rel.* Johnson-Pochardt v. Rapid City Reg'l Hosp., 252 F. Supp. 2d 892, 900 (D.S.D. 2003) (citation omitted).

any "indication of comparative weight,"[95] they fail to clearly delineate whistleblowers' expected performance.

4. Terms of Settlement

Another important aspect of settling qui tam litigation is the specification of terms—i.e., the amount of damages, admissions of wrongdoing, confidentiality, and other provisions—that are incorporated into a final resolution. Where the government intervenes in a qui tam action, it naturally takes the lead in negotiating a settlement. The negotiations often center on the amount of calculated damages sustained by the government and the multiplier to be applied to the damages figure.[96] While the government rarely settles for single damages, the 3.0 multiplier found in the statute is not mandatory,[97] and the multiplier may often land somewhere between 1.0 and 3.0 in a final settlement, giving the government significant leeway in crafting settlements that take into account the defendant's cooperation and conduct during the FCA investigation.[98]

Additionally, in the healthcare context, the government has routinely begun to utilize Corporate Integrity Agreements (CIAs) in conjunction with the settlement of underlying FCA claims, which impose defendant-specific compliance reforms and provide for continued monitoring of compliance efforts.[99] Many healthcare providers agree to enter into these costly CIAs because of the threat of exclusion from the Medicare and Medicaid programs.[100] The Office of the Inspector General (OIG) of the Department of Health and Human Services (HHS) has also implemented a Provider Self-Disclosure Protocol that provides incentives to healthcare contractors to cooperate and self-report wrongdoing, including lower damages multipliers, releases from permissive exclusion from Medicare and Medicaid programs, and a presumption against the imposition of CIAs.[101]

---

95. *See id.*

96. *See* Janice M. Symchych et al., *Settlement of Major Healthcare Fraud Enforcement Proceedings: A Probing and Frank Analysis of the Competing Variables*, 25 A.B.A. SEC. HEALTH LAW 1, 2, 8 (2013).

97. Any person who violates the FCA is liable for three times the amount of damages, but the government may, and often does, settle for less. *See* 31 U.S.C. § 3729(a)(1) (2012).

98. James D. Wareham & Candice S. Shepherd, 9th Annual Corporate Counsel Institute at Georgetown University Law Center Continuing Legal Education: Managing Whistleblower Claims Under the False Claims Act (Mar. 10, 2005), *available at* 2005 WL 1611863, at *13 ("The company's cooperation with the government during the government's investigation is a key factor in the government's willingness to reduce the multiplier.").

99. *See* Symchych et al., *supra* note 96, at 11–12.

100. *See* Sharon Finegan, *The False Claims Act and Corporate Criminal Liability: Qui Tam Actions, Corporate Integrity Agreements and the Overlap of Criminal and Civil Law*, 111 PENN. ST. L. REV. 625, 651 (2007); *see also* 42 U.S.C. § 1320a-7 (2012).

101. *See* U.S. DEP'T OF HEALTH AND HUMAN SERVS., OFFICE OF INSPECTOR GENERAL, OIG's Provider Self-Disclosure Protocol 2 (April 17, 2013), *available at* http://oig.hhs.gov/compliance/self-disclosure-info/files/Provider-Self-Disclosure-Protocol.pdf. Other federal agencies have employed similar voluntary disclosure programs in the past, and the Federal Acquisition Regulation (FAR) Council has mandated disclosure

Separately, the DOJ has increasingly entered into deferred prosecution agreements (DPAs) and nonprosecution agreements (NPAs) with corporate defendants in the criminal context, which similarly require cooperating firms to implement rehabilitating measures and install corporate monitors in exchange for the avoidance of criminal liability.[102] In contrast to CIAs, defendants entering into DPAs or NPAs are expected to accept admissions of conduct that are sufficient to establish criminal liability, as is required in a standard criminal plea agreement.[103] These disclosure programs and standardized agreements seek to incentivize cooperation and deter future misconduct by federal contractors.

II. AGENCY COSTS

Agency cost theory involves the examination of principal-agent relationships, the losses created from the divergence of the parties' interests, and the devices employed to reduce those losses.[104] This section provides an overview of the basic principles of agency cost theory and its application. Specifically, Part II.A provides a primer on the theory along with examples from the FCA context, and Part II.B provides a more in-depth application of agency cost theory in the context of corporate crimes.

A. Theoretical Primer

Michael C. Jensen and William H. Meckling define an agency relationship as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent."[105] Agency relationships arise wherever both parties expect to

---

of FCA violations for government contractors involved in procurement contracts. *See* Timothy M. Cox, *Is the Procurement Integrity Act "Important" Enough for the Mandatory Disclosure Rule? A Case for Inclusion*, 40 PUB. CONT. L.J. 347, 371–77 (2011) (discussing FAR's mandatory disclosure rules and the Department of Defense's now defunct voluntary disclosure program).

102. *See* Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW 144, 152 (Keith N. Hylton & Alon Harel eds., 2011). In two memoranda issued in 2008 and 2010, the DOJ provided guidance for the selection of monitors, and their mandates, in connection with DPAs and NPAs. *See* U.S. DEP'T OF JUSTICE, U.S. ATTORNEY'S MANUAL, CRIMINAL RESOURCE MANUAL 166 (2010), *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm00166.htm; U.S. DEP'T OF JUSTICE, U.S. ATTORNEY'S MANUAL, CRIMINAL RESOURCE MANUAL 163 (2008), *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/crm00163.htm.

103. *See* Arlen, *supra* note 102, at 152; *see also* Symchych et al., *supra* note 96, at 10 (noting the customary presence of "no admission" clauses in civil but not criminal settlements); U.S. DEP'T OF HEALTH AND HUMAN SERVS., OFFICE OF INSPECTOR GENERAL, *supra* note 101, at 14 ("OIG does not demand an admission of liability in settlement agreements . . . .").

104. *See* Scott, *supra* note 19.

105. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

derive a net benefit—usually when an efficient division of labor or specialization will result.[106] Accordingly, in the FCA context, agency relationships exist between the government (principal) and relator-whistleblowers (agents)[107] and between the government (principal) and federal contractors (agents). Government contractors that operate as corporate firms involve agency relationships between corporate shareholders that own the company (principals) and the corporate managers (agents) that run the company on their behalf. In addition, as Jensen and Meckling note, "there are agency costs generated at every level of the organization."[108] A CEO supervises mid-level managers, who in turn supervise their low-level employees—different agency costs will arise at each of these levels and at every gradation in between.[109] Thus, agency relationships also exist between managers (principals) and potential employee-whistleblowers (agents).

The interests of an agent and the interests of its principal diverge in almost every type of agency relationship.[110] For example, a federal contractor may cut corners on a government job to pocket more money for itself, or a relator may conduct a qui tam action for monetary gain despite its net negative social costs. Agency costs involve the expenditures required to better align these agents' interests with the interests of their principals.

Jensen and Meckling define agency costs as "the sum of: (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, [and] (3) the residual loss."[111] The first category, monitoring costs, involves not only the oversight by principals of agents' activities but includes efforts by the principal "to 'control' the behavior of the agent through budget restrictions, compensation policies, operating rules, etc."[112] Monitoring costs may include financial audits, corporate compliance programs, and supervision of employees' activity. In the FCA context, the government's decision to continue monitoring qui tam cases in which it elects not to intervene is representative of these monitoring costs.[113] A corporate firm may also decide to erect internal compliance programs and controls to monitor employees' behavior and prevent FCA violations.

---

106. Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U. L. REV. 515, 536 (2007).

107. At least one district court has explicitly adopted the conception of the relator-government relationship as one grounded in agency law. *See* Jonathan H. Gold, *Legal Duties That Qui Tam Relators and Their Counsel Owe to the Government*, 20 GEO. J. LEGAL ETHICS 629, 641 (2007).

108. *See* Jensen & Meckling, *supra* note 105, at 309 n.10.

109. *Id.*

110. *Id.* at 308.

111. *Id.*

112. *Id.* at 308 n.9.

113. *See supra* note 70 and accompanying text.

Bonding costs involve payments made by the principal to the agent "to guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions."[114] The classic example of bonding costs in the corporate context involves tying an agent's compensation to the principal's profitability through profit-sharing or stock options.[115] In the FCA context, the DOJ's Relator's Share Guidelines strive to create similar bonding costs that serve to align the relator's interests with the government's interest in a successful resolution of FCA litigation.[116] Additionally, corporate firms may require employees to sign agreements that obligate the disclosure of information regarding all known or suspected fraudulent activity to the corporation and the release of the corporation from all future claims brought by the employee based on such information.[117] These types of agreements represent bonding costs borne by potential employee-whistleblowers.

The last category of agency costs involves residual loss, a catchall for the losses incurred due to the limits of monitoring and bonding costs. In an agency relationship, "[r]ational principals will expend effort on monitoring and bonding until their marginal price of doing so is less than the expected benefit."[118] Where monitoring and bonding stop paying off, residual loss steps in. In the FCA context, a relator's decision to pursue or settle an FCA action on terms more favorable to the relator, rather than the government, represents residual loss in the relator-government relationship.[119] Similarly, a corporation's decision to cover up wrongdoing, rather than self-report to the government, involves residual loss in the corporate-government relationship. Yet, where the monitoring and bonding costs incurred no longer outweigh their benefits, these residual losses are not necessarily inefficient or suboptimal.[120] They are simply an unavoidable result of the particular agency relationship.[121]

---

114. *See* Jensen & Meckling, *supra* note 105, at 308.

115. *See* Christopher R. Leslie, *Cartels, Agency Costs, and Finding Virtue in Faithless Agents*, 49 WM. & MARY L. REV. 1621, 1637 (2008).

116. *See supra* notes 91–93 and accompanying text. The Relator's Share Guidelines include increases in the percentage recovery for prosecution of the action in line with the government's interests and decreases in the percentage recovery for relator behavior that cuts against the government interest. *Id.*

117. In *United States ex rel. Wildhirt v. AARS Forever, Inc.*, No. 09 Civ. 1215, 2013 WL 5304092 (N.D. Ill. Sept. 19, 2013), the relators, employees of a healthcare provider, were required to sign confidentiality agreements and specific "Confidential Acknowledgment of No Known Suspect Practices" statements in which relators certified that they were unaware of any suspect business practices (including FCA violations) or had otherwise reported any suspect practices to company management. *Id.* at *3. The court conditionally allowed the defendant to bring counterclaims for breach of the "No Known Suspect Practices" statements, provided that the defendant was not found liable for the alleged FCA violation. *Id.* at *7.

118. *See* Peterson, *supra* note 106, at 540.

119. *See* Rich, *supra* note 62, at 1254.

120. *See* Jensen & Meckling, *supra* note 105, at 327–28.

121. *Id.* at 328.

Social norms, contractual obligations, and the legal system attempt "to more closely align the incentives of agents and their principals."[122] The legal system seeks to accomplish this task primarily through duty-based liabilities; most notably, fiduciary duties that apply to particular principal-agent relationships.[123] In addition, a bevy of rules and regulations (such as corporate governance and SEC reporting) have been put in place through the legal system to deter agents from straying from their principals' interests.

The legal framework that governs agency relationships not only seeks to align the incentives of principals and agents, it also addresses the rights of third parties affected by the actions of agents acting on behalf of their principals.[124] The judicially created construct of vicarious liability allows an individual harmed by a principal's agent to recover from the principal for the losses incurred.[125] The vicarious liability standard recognizes that principals can use an agency relationship "to capture an agent's comparative advantage in both socially beneficial *and* socially destructive behavior."[126] Vicarious liability forces a principal (e.g., a corporation's shareholders) to internalize the socially destructive costs of an agent's actions, creating incentives to engage in monitoring and bonding to deter the agent from engaging in any socially destructive behavior.[127] The construct of vicarious corporate liability—holding government contractors liable (and forcing them to pay sufficiently high fines) for frauds committed by their employees—creates an incentive for the implementation of monitoring and compliance programs to deter such crimes.[128]

B. Agency Costs and Corporate Fraud

Jennifer Arlen and Reinier Kraakman have outlined a model for structuring the optimal scheme for corporate liability.[129] Arlen notes that in large publicly traded corporations, imposing strict corporate liability alone will lead to suboptimal deterrence because the short-term interests of agents

---

122. *See* Peterson, *supra* note 106, at 537.

123. RESTATEMENT (SECOND) OF TORTS § 874 (1979) ("One standing in a fiduciary relation with another is subject to liability to the other for harm resulting from a breach of duty imposed by the relation.").

124. *See* Peterson, *supra* note 106, at 540.

125. *See* Am. Soc'y of Mech. Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 566 (1982) ("[A] principal is liable for an agent's misrepresentations that cause pecuniary loss to a third party, when the agent acts within the scope of his apparent authority." (citing RESTATEMENT (SECOND) OF AGENCY §§ 249, 262 (1957))).

126. *See* Peterson, *supra* note 106, at 541.

127. *See* United States v. O'Connell, 890 F.2d 563, 567–69 (1st Cir. 1989) (noting that under the FCA, corporations may be "held vicariously liable in order to deter violations and to protect the public").

128. Jennifer Arlen, Public Versus Private Enforcement of Securities Fraud 20 (2007) (unpublished manuscript), *available at* http://weblaw.usc.edu/assets/docs/Arlen.pdf.

129. Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997).

often diverge significantly from those of the corporation's shareholders.[130] Arlen and Kraakman advocate the employment of a composite liability regime to optimally deter crime—strict vicarious liability coupled with duty-based measures to increase the probability that such crimes will be detected.[131] Such a composite liability regime induces firms to adopt "policing measures" aimed at detecting and self-reporting wrongdoing.[132] It also induces firms to adopt "preventive measures" that reduce the benefit or increase the direct costs of corporate crime.[133]

A composite corporate liability regime combines strict liability for violations—corporations are forced to pay for the misconduct of their agents—with increased liability where firms fail to adopt effective policing and prevention measures.[134] Firms that do not meet their "duty-based" obligations of monitoring, self-reporting detected wrongs, and full cooperation, will face increased penalties for their failures beyond the default penalty imposed under the strict liability framework.[135] Under this composite framework, the penalty imposed on firms which do not meet their policing or prevention duties must be greater than the expected sanction when firms do police optimally but still commit misconduct, taking into account that a failure to police will decrease the probability of detection and sanction.[136] In other words, corporations must expect to face a large enough penalty for failure to comply such that it makes economic sense to implement internal compliance and cooperation procedures, even though both compliance and cooperation will increase the chance of being held liable for a violation. Additionally, the duty-based policing and prevention measures must be sufficiently detailed so that firms have clear guidance on the nature of their required monitoring and policing duties and the nature of the enhanced sanctions imposed where firms fail to meet these duties.[137]

Arlen and Kraakman's composite liability framework has been successfully implemented in the criminal context, where the DOJ has employed a mix of strict corporate liability with duty-based sanctions for firms that do not monitor, self-report, and cooperate with authorities.[138] In 1999, the DOJ adopted a formal policy governing corporate criminal liability where firms can avoid or mitigate penalties by following a clear

---

130. *See* Arlen, *supra* note 102, at 144.
131. *See* Arlen & Kraakman, *supra* note 129, at 699, 726.
132. *Id.* at 699.
133. *Id.*
134. *See id.* at 726.
135. *Id.* at 727; *see also* Arlen, *supra* note 102, at 185 (describing a "multi-tiered composite duty-based liability that clearly specifies that the firm is subject to three duties (*ex ante* monitoring, self-reporting of detected wrongs, and full cooperation), and provides clear guidance on the nature of these three duties and the sanctions for violating each").
136. *See* Arlen, *supra* note 102, at 180–81.
137. *See id.* at 191.
138. *Id.* at 151–52.

framework for cooperation.[139] The DOJ's policy has been clearly outlined in a succession of memoranda and guidance in DOJ manuals that detail how corporations can receive "cooperation credit" or "mitigating credit" in the criminal context for cooperating with authorities and self-reporting wrongdoing.[140]

III. AGENCY COST ANALYSIS OF THE FALSE CLAIMS ACT

As discussed above, the FCA framework is replete with examples of agency relationships and their attendant costs.[141] Analyzing the FCA qui tam provisions utilizing an agency cost approach allows one to determine the advantages and disadvantages of the FCA statutory framework. Part III.A presents an agency cost analysis of the advantages of the qui tam provisions of the FCA, exploring the increased prosecution and detection and the self-monitoring encouraged by qui tam actions. Part III.B analyzes the agency costs involved in the potential disadvantages of the qui tam provisions, including the disincentives to investing in policing and preventions measures, barriers to full cooperation with the government, and the incentivizing of frivolous qui tam suits.

A. Advantages

It is clear from recent record-setting FCA recoveries that the qui tam framework provides distinct advantages in enhancing FCA enforcement.[142] As the FCA's chief proponent Senator Charles Grassley has noted, "[t]he fact is that no other law in existence has been more effective in battling fraud than the False Claims Act has in the past 25 years."[143] The reasons for the FCA's success stem from the qui tam structural incentives, which have spurred greater enforcement by the DOJ, increased detection of fraud

139. *See* Jennifer Arlen, *The Failure of the Organizational Sentencing Guidelines*, 66 U. MIAMI L. REV. 321, 358–59 (2012) ("Recognizing the need to provide firms with stronger incentives to detect crimes, report them, and fully cooperate, in 1999 then-Deputy Attorney General Eric Holder effectively adopted an alternative regime to govern the sanctioning of firms that adopted an effective compliance program, self-reported, or fully cooperated with federal authorities.").

140. The original guidelines issued in 1999 were referred to as the "Holder memo" in reference to then-deputy Attorney General Eric Holder who authored the memorandum. *See* Arlen, *supra* note 102, at 151. The Holder memo has been updated since 1999 and has been included in official DOJ guidance. *See* U.S. DEP'T OF JUSTICE, U.S. ATTORNEY'S MANUAL § 9–28.000 (2008), *available at* http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm.

141. *See supra* notes 107–09, 113, 116, 119 and accompanying text.

142. *See supra* note 14 and accompanying text.

143. *Oversight of the False Claims Act: Hearing Before the Subcomm. on the Constitution and Civil Justice of the H. Comm. on the Judiciary*, 113th Cong. (2014) (statement of Sen. Charles E. Grassley) ("Before the 1986 amendments, [the FCA] brought in a tiny fraction of what it does today, only about $40 million a year. At that rate, it would have recovered only $1 billion in the past 25 years. Thanks to the 1986 amendments, it's brought back 42 times that much. Clearly, the False Claims Act is working, and it's working fantastically.").

by employee-relators, and provided a unique deterrent threat to corporate fraud.

1. Increased Fraud Prosecution and Detection

The FCA's qui tam system functions as a monitoring system for taxpayers to ensure that public enforcers increase prosecution and detection of fraud.[144] In this agency model, the taxpayers represent the principals, and the public enforcers, the DOJ's attorneys, represent the agents. Just as in any principal-agent relationship, prosecutors' incentives often do not align with those of the taxpayers, especially because public enforcers are not motivated by monetary gain and thus often do not have an economic incentive to maximize fraud recoveries.[145] As a result, the DOJ may well underenforce when it comes to fraud perpetrated against the government. The qui tam provisions force government attorneys to devote more time and resources to aggressively attacking fraud against taxpayers,[146] thereby aligning the DOJ's practices with the stated goals of legislators who continue to encourage a more aggressive stance toward rooting out fraud.[147] Qui tam relators and their counsel have been responsible for pushing novel theories of liability that prosecutors were initially loathe to pursue—most notably, FCA claims based on off-label marketing of pharmaceuticals, which have brought in billions of dollars in fraud recoveries.[148] Indeed, qui tam relators' actions largely spurred the DOJ's current aggressive

144. *See* Kovacic, *supra* note 20, at 1822–24.

145. *See* Howse & Daniels, *supra* note 20, at 543–44 ("From an agency theory perspective, even where the government itself is acting in the public interest, delegated decision-makers within government, such as prosecuting attorneys or investigators, may have interests that are not fully aligned with those of government."); *see also* William B. Rubenstein, *On What a "Private Attorney General" Is—And Why It Matters*, 57 VAND. L. REV. 2129, 2139 (2004).

146. *See* Kovacic, *supra* note 20, at 1806 ("The 1986 reforms sought to cure [the problem] . . . that government law enforcement bodies fail to attack fraud as aggressively as taxpayers would prefer.").

147. *See, e.g.*, *Combating War Profiteering: Are We Doing Enough to Investigate and Prosecute Contracting Fraud and Abuse in Iraq?: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 2 (2007) (statement of Sen. Patrick J. Leahy, Chairman, S. Comm. on the Judiciary) ("During the nearly 4 years of war, the Department of Justice has failed to move aggressively enough in prosecuting fraud in Iraq.").

148. The first off-label FCA case was pursued by a relator in a non-intervened *qui tam* action. *See* United States *ex rel.* Franklin v. Parke-Davis, 147 F. Supp. 2d 39 (D. Mass. 2001). Since 2001, off-label FCA cases brought by relators have resulted in massive recoveries for the federal government. *See, e.g.*, Duff Wilson, *Novartis Settles Off-Label Marketing Case Over 6 Drugs for $422.5 Million*, N.Y. TIMES, Oct. 1, 2010, at B5; Press Release, U.S. Dep't of Justice, Allergan Agrees to Plead Guilty and Pay $600 Million to Resolve Allegations of Off-Label Promotion of Botox® (Sept. 1, 2010), http://www.justice.gov/opa/pr/2010/September/10-civ-988.html; Press Release, U.S. Dep't of Justice, Eli Lilly and Company Agrees to Pay $1.415 Billion to Resolve Allegations of Off-Label Promotion of Zyprexa (Jan. 15, 2009), http://www.justice.gov/opa/pr/2009/January/09-civ-038.html.

prosecution of off-label FCA cases.[149] In this regard, the qui tam provisions have pushed the DOJ away from avoiding excessive risk aversion and toward what may be a more socially desirable level of enforcement and deterrence.[150] The qui tam provisions have been indisputably successful in checking perceived prosecutorial reticence and reducing monitoring costs in the taxpayer-prosecutor relationship, which was a major impetus for the legislative overhaul of the FCA in 1986.[151]

The qui tam provisions also provide an effective method for acquiring "high-level, detailed, inside information" concerning corporate frauds.[152] Corporate fraud is notoriously hard to uncover, and detection absent inside information requires a considerable amount of investigative resources.[153] As a result, a large portion of fraud often goes undetected.[154] As supporters of the FCA have noted, qui tam relators serve an important role in bringing this fraud to light because violators will otherwise cover up wrongdoing, destroy or alter evidence, and generally not cooperate with investigations.[155] The unique nature of fraud and the concomitant need for increased incentives for detection has also led to the institution of whistleblower incentives in other contexts such as tax fraud[156] and

---

149. Subsequent to *Parke-Davis*, the DOJ has aggressively pursued off-label FCA cases. *See* Rich, *supra* note 62, at 1270–73. Professor Rich argues that the *Parke-Davis* experience represents an undue usurping of the DOJ's prosecutorial discretion. *See id.* at 1273–74. However, the fact that the DOJ has pursued such off-label cases with increasing vigor seems to support the conclusion that the DOJ actually underenforced in the off-label marketing space prior to *Parke-Davis* and its progeny.

150. *See* Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2195–96 (2010); *see also* Howse & Daniels, *supra* note 20, at 543 ("The possibility of the government failing to prosecute wrongdoing . . . reinforces the value of a private right of action as a means of 'guarding the guardians.'").

151. *See* Engstrom, *supra* note 87, at 1273 n.100.

152. Pamela H. Bucy, *Game Theory and the Civil False Claims Act: Iterated Games and Close-Knit Groups*, 35 LOY. U. CHI. L.J. 1021, 1026 (2004).

153. *See* Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 835 (1994) ("Many corporate crimes—such as securities fraud, government procurement fraud, and some environmental crimes—cannot be readily detected by the government."); *see also* Brian K. Payne & Bruce L. Berg, *Looking For Fraud in All the Wrong Places*, 70 POLICE J. 220, 222 (1997) (discussing the difficulty of detecting fraud in government healthcare programs).

154. Best estimates are that approximately 14.5 percent of large public corporations engage in fraud, and only 27.5 percent of fraud is caught. *See* I.J. Alexander Dyck, Adair Morse & Luigi Zingales, *How Pervasive Is Corporate Fraud?* tbl.2 (Rotman School of Management, Working Paper No. 2222608, 2013), *available at* http://dx.doi.org/10.2139/ssrn.2222608.

155. *See False Claims Correction Act of 2007: Joint Hearing on H.R. 4854 Before the Subcomm. on Courts, the Internet, and Intellectual Property and the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 47 (2008) (statement of Shelley R. Slade, Partner, Vogel, Slade & Goldstein, LLP) ("Without the help of insiders who brought the Government documents and other hard evidence of the fraud, it would have been extremely difficult for the Government to develop sufficient evidence to establish liability in many of the successful FCA cases.").

156. *See* I.R.C. § 7623 (2012).

securities fraud.[157] Indeed, whistleblowing may be "the single most effective method of detecting corporate and financial fraud."[158]

2. "Self"-Monitoring

The qui tam structure also effectively enlists lower-level agents to engage in monitoring of higher-up corporate managers. The current FCA framework encourages lower-level employees to monitor shareholders' agents (corporate managers) without the need for shareholders to engage in traditional top-down monitoring procedures. If corporate managers know that their own employees are on the lookout for fraudulent activity, they will be less inclined to participate in the commission of these frauds or recklessly allow them to occur.[159] Indeed, corporate managers that conspire to commit or cause FCA violations may be held personally liable for those violations.[160] These incentives also inure to shareholders' benefit because managers faced with the threat of personal FCA liability will be deterred from engaging in otherwise profitable violative conduct. The ex ante knowledge of the probability of monitoring by potential qui tam relators plays an integral role in deterring corporate agents from engaging in fraud.[161]

B. Potential Disadvantages

Several commentators have noted that the whistleblower incentives created by the FCA are potentially harmful to the internal organization of corporations.[162] Unlike in the context of criminal corporate liability, where the prevailing enforcement framework incentivizes robust internal compliance and monitoring procedures and cooperation with criminal investigations,[163] the FCA whistleblower framework creates incentives to disfavor internal compliance reporting and cooperation with civil

157. *See* 15 U.S.C. § 78u–6 (2012).

158. *See Legislative Proposals to Address the Negative Consequences of the Dodd-Frank Whistleblower Provisions: Hearing Before the Subcomm. on Capital Mkts. and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 112th Cong. 10 (2011) (statement of Geoffrey Christopher Rapp, Professor of Law, Univ. of Toledo College of Law).

159. In extreme cases, this type of "self"-monitoring can interfere with legitimate management choices. *See* Kovacic, *supra* note 20, at 1826–27. Where management decisions tread close to the line of permissibility, monitoring by lower-level agents can effectively inhibit lawful, and economically efficient, management decisions. *Id.* at 1827.

160. *See* Press Release, U.S. Dep't of Justice, Manhattan U.S. Attorney Announces $1.7 Million Settlement with Testquest, $2.3 Million Judgment Against Former Testquest Manager, and Filing of Criminal and Civil Charges Against Public School Teacher in Connection with Scheme to Defraud Federal Government into Paying for Tutoring Services That Were Never Provided (Aug. 9, 2013), http://www.justice.gov/usao/nys/pressreleases/August13/TestquestSettlement.php.

161. *See* Dyck et al., *supra* note 154, at 18.

162. *See* Callahan & Dworkin, *supra* note 39, at 334–35 (noting the conflict of interest employees face between reporting internally and blowing the whistle externally).

163. *See supra* notes 139–40 and accompanying text.

investigations, thereby actively impeding the "duty-based" corporate liability framework posited by Arlen and Kraakman as providing socially optimal deterrence. Under the current FCA framework, these incentives exacerbate the "inevitable divergence of self interest between principal and agent."[164]

1. Bypassing Internal Compliance Procedures

Potential relators benefit from bypassing corporate compliance procedures and bringing allegations and evidence of fraud directly to the government. For example, because of the public disclosure bar[165] and first-to-file provision,[166] an employee that reports malfeasance up the chain to her superiors may find that any recovery under the FCA will be foreclosed. If managers disclose the allegations to the government or another employee files a qui tam suit first before the aspiring whistleblower files her own complaint in district court, the qui tam action may be precluded.[167] Thus, in theory, employees on their "race to the courthouse" are incentivized to bypass internal reporting procedures that would otherwise alert management to fraud.[168] This apparent incentive to bypass internal compliance procedures might be expected to eliminate the gains achieved from socially optimal corporate liability regimes.

However, the bypassing of internal compliance procedures by relators is not observed with any regularity. Indeed, evidence suggests that the vast majority of employee-relators report wrongdoing internally before filing a qui tam action.[169] As noted above, this may be attributable to the fact that whistleblowers are often motivated by personal or altruistic concerns rather than purely economic incentives.[170] Potential whistleblowers are incentivized to first report up before reporting out, because of self-

---

164. *See* Scott, *supra* note 19.

165. 31 U.S.C § 3730(e)(4)(a) (2012).

166. *Id.* § 3730(b)(5).

167. *See* United States *ex rel.* Grant v. Rush-Presbyterian/St. Luke's Med. Ctr., No. 99 Civ. 06313, 2001 WL 40807, at *4 (N.D. Ill. Jan. 16, 2001) (public disclosure bar applied to lawsuit filed by employee after hospital affirmatively provided information to government authorities of fraudulent billing practices).

168. *See* Kovacic, *supra* note 20, at 1831 ("[E]mployees may choose to file *qui tam* suits instead of resorting to internal anti-fraud mechanisms such as hotlines."); *see also* U.S. CHAMBER INST. FOR LEGAL REFORM, FIXING THE FALSE CLAIMS ACT: THE CASE FOR COMPLIANCE-FOCUSED REFORMS 18–19 (2013), *available at* http://instituteforlegalreform.com/uploads/sites/1/Fixing_The_FCA_Pages_Web.pdf.

169. ETHICS RES. CTR., INSIDE THE MIND OF A WHISTLEBLOWER: A SUPPLEMENTAL REPORT OF THE 2011 NATIONAL BUSINESS ETHICS SURVEY 13 (2012), *available at* http://www.ethics.org/files/u5/reportingFinal_0.pdf ("Only three percent of [whistleblower] reports were made externally at first, but of the secondary reports almost four times as many were made to someone outside . . . ."); NAT'L WHISTLEBLOWERS CTR., IMPACT OF QUI TAM LAWS ON INTERNAL CORPORATE COMPLIANCE: A REPORT TO THE SECURITIES EXCHANGE COMMISSION 4 (2010), *available at* http://www.whistleblowers.org/storage/whistleblowers/documents/DoddFrank/nwcreporttosecfinal.pdf.

170. *See supra* notes 80–86 and accompanying text.

preservation, potential effects on savings and pensions, personal reputation, and "the undiversified human capital investment" in the employee's corporation.[171] In addition, the original source exception allows a relator to still recover even if they first report internally,[172] and the 2009 amendments to the FCA also provide an incentive to report up the internal compliance chain by covering internal reporting as protected activity under the FCA's antiretaliation provisions.[173]

The real threat to internal compliance programs, especially in the civil FCA context, involves the cost-benefit analysis that corporate firms must employ when deciding to implement and enforce *effective* internal compliance programs. Even in instances where corporations employ internal compliance programs, these programs may function as mere "window dressing," divorced from the actual day-to-day business of the organization and meant only to provide the appearance of legitimacy.[174] Indeed, corporate managers may well encourage internal reporting to ineffective compliance programs to prevent the external reporting of violations, especially in instances where corporations face inadequate penalties for otherwise profitable violations.[175] It is unsurprising that corporate firms, absent a statutory requirement, will not adopt effective internal compliance procedures because the costs of these provisions often outweigh the benefits.[176]

Additionally, when corporate management learns of misconduct or failures that may trigger a violation of the FCA, they are disincentivized from sharing information regarding the problem with the widest number of employees in search of a solution, for fear that they may provide an employee with the basis for an FCA suit.[177] Firms that employ internal investigations of possible FCA violations in contemplation of voluntary disclosure to the government may find that employees involved become qui tam relators, reporting externally before the problem can be dealt with internally, thereby short-circuiting any benefits of conducting a robust internal investigation.[178] Thus, the internal investigation of possible wrongdoing can create undue agency costs for the corporate firm—limiting information sharing and hampering firm-wide problem solving.

---

171. *See* Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1909–10 (2007) (discussing whistleblower motivations by analyzing the case of Enron whistleblower Sherrod Watkins).

172. *See* 31 U.S.C. § 3730(e)(4) (2012).

173. *See supra* notes 52–53 and accompanying text.

174. Justin Blount & Spencer Markel, *The End of the Internal Compliance World As We Know It, or an Enhancement of the Effectiveness of Securities Law Enforcement? Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provisions*, 17 FORDHAM J. CORP. & FIN. L. 1023, 1043–47 (2012).

175. *See id.* at 1050.

176. *See* Macey, *supra* note 171, at 1937–38.

177. *See* Kovacic, *supra* note 20, at 1833.

178. *See* Stephen Robert Geisler, *Voluntary Disclosure of Corporate Violations of Federal Law*, 51 ALA. L. REV. 375, 384–86 (1999).

2. Disincentives to Cooperate and Self-Report

The current FCA statutory scheme, and its implementation by the DOJ, also discourages corporations from self-reporting and fully cooperating with government investigations. The current FCA statute does contemplate reduced damages—from treble to double—if corporations self-report fraud within thirty days of learning of a possible violation;[179] however, very few firms are able to meet the strict self-reporting requirements of the statute.[180] Indeed, most firms choose not to self-report the violations they uncover through internal compliance programs, deciding rather to cover up wrongdoing or suppress whistleblower activity.[181] Even in instances where corporations do timely self-report, the public disclosure bar may not be triggered, and a corporation may still face significant FCA liability.[182]

---

179. *See* 31 U.S.C. § 3729(a)(2) (2012).

180. *See* Vt. Agency of Natural Res. v. United States *ex rel.* Stevens, 529 U.S. 765, 785 n.16 (2000) ("[T]reble damages may be reduced to double damages in certain cases . . . . This exception, however, applies only in some of those (presumably few) cases involving defendants who provide information concerning the violation before they have knowledge that an investigation is underway.") (citations omitted); *see also* John C. Ruhnka, Edward J. Gac & Heidi Boerstler, *Qui Tam Claims: Threat to Voluntary Compliance Programs in Health Care Organizations*, 25 J. HEALTH POL. POL'Y & L. 283, 299 (2000) (discussing the "very serious flaws with [the] FCA incentive for voluntary disclosure").

181. *See* Michael M. Mustokoff, Robin Locke Nagele & Jonathan Swichar, *To Disclose or Not to Disclose: There Should Be No Question*, 13 A.B.A. SEC. HEALTH LAW 28, 32 (2001) ("[T]he best advice for the least visible offenders must continue to be 'when in doubt—wait it out.'"). The experience of FCA whistleblower Stephen Huey is exemplary of the prevailing corporate attitude toward self-disclosure. In July 2009, Mr. Huey, then chief financial officer and vice president of finance of Summit Healthcare Association ("Summit"), a Medicare provider, brought the company's improper billing of Medicare to the attention of its board of directors. *See* United States v. Summit Healthcare Ass'n, No. 10 Civ. 08003 (PCT) (FJM), 2011 WL 814898, at *2 (D. Ariz. Mar. 3, 2011). At a board meeting, Huey explained that audits had revealed Summit was admitting patients who did not meet Medicare criteria and nevertheless submitting claims for reimbursement for those patients, in contravention of Medicare guidelines. *Id.* at *2–3. Huey recommended that Summit "quantify its exposure, self-report, and return any overpayments to the government." *Id.* at *2. However, Summit's chief executive officer counseled Summit's board that the company need not self-report "but instead wait to see if Medicare 'caught' the issues." *Id.* During a subsequent board meeting in September 2009, Huey again tried to explain Summit's liability under the FCA for retaining the Medicare overpayments but was rebuffed by Summit's CEO. *Id.* Huey subsequently made written reports of the compliance violations using Summit's internal reporting procedures in October and November of 2009, but he was later fired, allegedly in retaliation for his internal reporting. *Id.* at *3–4. After his termination, Huey filed a qui tam action in federal court, including allegations of FCA violations that he had originally brought to the board's attention and a claim for retaliation. *Id.* at *3.

182. For example, in July 2004, a quality control employee at defense contractor General Dynamics reported an alleged FCA violation to the contractor's corporate management. *See* United States *ex rel.* Lockhart v. Gen. Dynamics Corp., 529 F. Supp. 2d 1335, 1336 (N.D. Fla. 2007). The employee informed management that he had been instructed by his immediate supervisors to forego certain mandatory testing on gunpowder used in ammunition sold to the government. *Id.* The corporate management of General Dynamics subsequently made an affirmative disclosure of the alleged FCA violation through the Department of Defense's Voluntary Disclosure Program. *Id.* Three days after the voluntary

Where firms employ effective internal compliance programs and self-report to the government, they increase the probability that corporate crimes will be detected and that the government will impose liability.[183] If the liability enhancement effect of having a successful compliance program exceeds the deterrent penalty, then a firm will likely not undertake adequate policing measures, because such measures will only serve to increase expected liability.[184] Thus, the current FCA framework overpenalizes firms that employ effective compliance programs and fully cooperate with the government relative to those firms that do not.

3. Overenforcement and Meritless Lawsuits

As noted above, it is not possible to accurately determine the relative percentage of parasitic and inaccurate lawsuits being filed in the FCA context, but the high dismissal rate associated with non-intervened qui tam cases supports the view that this is a potential problem.[185] The large monetary incentives provided by the FCA's qui tam provisions create the possibility for fabrication of claims for profit.[186] Moreover, fears of fabricated and frivolous claims are reasonable where private enforcement supplements public enforcement. Absent private enforcement, an "idealized public enforcer" would presumably be sensitive to the overdeterrence ramifications of prosecuting cases where liability is questionable.[187] Conversely, where the qui tam award is high enough to make litigation profitable, "the predictable result would be an increase in over-deterrence costs relative to a world with only public enforcement."[188] This indifference to the social costs of qui tam lawsuits may encourage a profit-motivated relator's counsel to bring frivolous claims, "using the threat of massive discovery costs or bad publicity to extract settlements when the social cost of adjudication would exceed any possible benefit or, worse, where culpability is entirely absent."[189] Indeed, relators' firms have been sanctioned for using aggressive tactics to seek out disgruntled employees and bringing frivolous suits in search of a nuisance value settlement.[190] The confidential settlement of nuisance value suits is often a

---

disclosure, the employee filed an FCA complaint on the basis of the alleged testing violation; on a motion to dismiss, the district court held that the voluntary disclosure to the Department of Defense program did not trigger the public disclosure bar absent any government follow-up. *Id.* at 1337–40.

183. *See* Arlen & Kraakman, *supra* note 129, at 708.

184. *Id.*

185. *See supra* notes 71–74 and accompanying text.

186. *See* Howse & Daniels, *supra* note 20, at 540 ("[I]t is often claimed that the prospect of large awards to whistleblowers provides an incentive for employees to fabricate claims of wrongdoing for personal profit.").

187. *See* Rose, *supra* note 150, at 2201.

188. *Id.*

189. *See* Engstrom, *supra* note 87, at 1254.

190. One district court decision, later overturned on appeal, accused relator's counsel of contacting ex-employees in hopes of "manufacturing an FCA lawsuit." United States v. ITT

rational choice for defendants faced with steep litigation costs, reputational harm, and the prospect of follow-on civil litigation.[191] The costs of settling a large number of nuisance value lawsuits would clearly pose a distinct disadvantage of the qui tam private right of action.

However, empirical data detailing a high incidence of frivolous nuisance value litigation is conspicuously lacking, especially in the FCA context.[192] Moreover, a certain level of frivolous suits may be inevitable, and more than justified, where qui tam cases expose massive frauds.[193] At bottom, it is not clear how such frivolous litigation might be curtailed without limiting other meritorious suits.[194] The generous whistleblower incentives that critics bemoan are the same incentives that encourage relators' law firms to handle complex and expensive cases,[195] and a specialized relators' bar may provide an important screening mechanism in determining which FCA suits have substantial merit.[196] Focusing on the profit-maximizing motivations of the relators' bar and altering the calculus involved in settling frivolous claims is likely the most fertile grounds for allaying concerns regarding overenforcement and limiting the filing of meritless lawsuits.

IV. PROPOSED REFORMS

The foregoing analysis of the FCA's statutory scheme highlights the issues that arise in the context of the multienforcer framework of the FCA, most notably the undue agency costs engendered by qui tam provisions that may lead to overdeterrence costs. Having identified particular problems, the next step involves determining how to optimally change the design of the FCA's multienforcer approach. One way to approach the issue is by legislative action—i.e., "adopting a narrower fraud prohibition, lower

---

Educ. Servs., Inc., No. 07 Civ. 00867 (TWP) (MJD), 2012 WL 1028794, at *4 (S.D. Ind. Mar. 26, 2012), *rev'd sub nom.* Leveski v. ITT Educ. Servs., Inc., 719 F.3d 818 (7th Cir. 2013). The court noted that, "[h]aving determined that this lawsuit is frivolous, the Court easily finds that it was brought for an improper purpose—presumably, to extract a large settlement from ITT, which would otherwise be forced to incur massive legal fees." *Id.* at *12.

191. *See* Todd J. Canni, *Who's Making False Claims, the* Qui Tam *Plaintiff or the Government Contractor? A Proposal to Amend the FCA to Require that All* Qui Tam *Plaintiffs Possess Direct Knowledge*, 37 PUB. CONT. L.J. 1, 11–12 (2007); *see also* William E. Kovacic, *The Civil False Claims Act As a Deterrent to Participation in Government Procurement Markets*, 6 SUP. CT. ECON. REV. 201, 225 (1998) ("As a rough rule of thumb, the survey data suggest that contractors incur out-of-pocket legal costs of at least $250,000 to $500,000 whenever the firm is informed that the government has commenced an inquiry into alleged [FCA] violations or a qui tam relator has filed a suit.").

192. *See* Lance P. McMillan, *The Nuisance Settlement "Problem": The Elusive Truth and a Clarifying Proposal*, 31 AM. J. TRIAL ADVOC. 221, 227 (2007); *see also* Engstrom, *supra* note 87, at 1269.

193. *See* Rapp, *supra* note 29, at 133.

194. *See supra* notes 87–88 and accompanying text. Legislators face difficult calibration challenges when seeking "to harness heterogeneous private enforcers." Engstrom, *supra* note 87, at 1295.

195. *See* Rapp, *supra* note 29, at 131.

196. *See* Engstrom, *supra* note 87, at 1257–59.

sanctions, or more defendant-friendly procedural rules."[197] Indeed, many commentators have advocated for these types of legislative fixes to the FCA framework, including instituting a direct knowledge requirement,[198] applying fee-shifting provisions to relator's counsel,[199] and raising the standard of proof for FCA liability.[200] However, such an approach is undercut by the lack of data on the social costs of both fraud and overdeterrence, which are "exceedingly difficult to observe and measure."[201] Moreover, empirical data regarding the economic incentives and social costs of private enforcement under the FCA is severely lacking,[202] making changes to the FCA's "substance, sanctions, and procedure" an approach fraught with uncertainty of whether such proposed reforms will do more harm than good.[203] For example, raising the standard of proof in the FCA context would no doubt "reduce the likelihood that meritless or weak qui tam cases would be filed under the FCA,"[204] but it would also reduce the filing of a large swath of meritorious qui tam cases where clear and convincing proof is not readily obtainable.

These observations lead to several useful changes to qui tam enforcement incentives that can be implemented through targeted policy changes, rather than through blunt legislative fixes that risk sacrificing prosecutorial flexibility. This part sets forth these proposals, which rely on the DOJ's discretion to create a standardized FCA settlement and cooperation framework, establishing clear incentives for potential whistleblowers and corporate defendants alike that will serve to better align the interests of these agents in their respective relationships with the government.

A. *Relator's Share Guidelines*

The DOJ's Relator's Share Guidelines already provide a rudimentary framework for incentivizing qui tam relators that does not require a legislative overhaul of the FCA.[205] To the extent that a number of potential whistleblowers are incentivized to file qui tam actions rather than report conduct internally through compliance programs, certain tweaks to whistleblowing incentives can go a long way. Rather than advocate for a change to the statutory framework, incentives can be built into a formal

197. Rose, *supra* note 150, at 2194.

198. *See* Canni, *supra* note 191, at 19–22.

199. *See* Sean Elameto, *Guarding the Guardians: Accountability in Qui Tam Litigation Under the Civil False Claims Act*, 41 PUB. CONT. L.J. 813, 848–51 (2012).

200. *See* U.S. CHAMBER INST., *supra* note 168, at 33–35; *see also* Finegan, *supra* note 100, at 676.

201. *See* Rose, *supra* note 150, at 2194.

202. *See supra* note 192 and accompanying text.

203. *See* Rose, *supra* note 150, at 2194; *see also* Engstrom, *supra* note 87, at 1322 ("[S]imple procedural barriers or caps on recoveries can have undesirable distributive impacts between claimant types or risk screening out good claims with bad.").

204. Finegan, *supra* note 100, at 676.

205. *See supra* notes 90–95 and accompanying text.

DOJ settlement procedure to incentivize the few relators that would rather report out than report up.

The twenty-five separate criteria included in the DOJ's Relator's Share Guidelines[206] should be replaced with three definite benchmarks that will signal to relators the percentage recoveries they can expect from any settlement or judgment. Rather than simply listing criteria that would point toward an increased or decreased percentage,[207] these benchmarks should require relators to meet definite criteria to receive a corresponding percentage recovery. First, internal employee-relators who file a qui tam action without reporting up contemporaneously or prior to filing, in the absence of good cause, would be limited to a 15 percent share of any resulting settlement amount. An increase to a 20 percent share would be warranted for relators and relators' counsel who provide substantial assistance in investigating and litigating the action. Finally, a 25 percent share would be reserved for those relators who truly go above and beyond by offering extraordinary assistance in pursuing the qui tam claim.

These benchmarks would be particularly effective in incentivizing the class of relators who are most likely to report out rather than report up—those relators who are swayed most by the monetary incentives of the qui tam award. Additionally, faced with a lower percentage recovery, a relator's counsel would presumably advise her client to report internally and file a qui tam complaint simultaneously in order to maximize the percentage recovery. Instituting clearly defined benchmarks for relator share percentages will help to better align the interests of relators and the government.

B. Corporate Cooperation

Although the FCA statute already rewards cooperating entities with a reduction from treble to double damages, as noted above, the standard for meeting the statutory criteria can be impossibly high.[208] As a result, many firms choose to "wait it out" rather than cooperate with the DOJ's investigations into FCA actions.[209] The DOJ already employs a model framework for encouraging corporate cooperation in the criminal context that has consistently produced positive results.[210] These lessons learned in the criminal context should be applied in the FCA context as well.

The DOJ can invoke its prosecutorial discretion to outline concrete duty-based incentives for corporate cooperation, policing, and prevention.[211] These criteria should include damages reductions where defendant firms employ functional compliance programs, timely self-report, and fully

206. *See* RELATOR'S SHARE GUIDELINES, *supra* note 91.
207. *See supra* note 93 and accompanying text.
208. *See supra* notes 179–82 and accompanying text.
209. *See supra* note 181.
210. *See supra* notes 138–40 and accompanying text.
211. *See supra* notes 134–37 and accompanying text.

cooperate with the DOJ's investigative efforts. In order to be effective, cooperating corporations should be offered full amnesty from exclusion or debarment from government programs where they meet the delineated criteria and fully reimburse the government.[212] Additionally, the criteria must be clear and concrete enough for FCA defendants and prosecutors to provide a standardized framework, much like the framework created by the analogous criminal corporate liability guidelines.[213]

Where corporations do not employ adequate policing and prevention measures and do not fully cooperate with the government, they should face a high default sanction in the range of double to treble damages and be required to enter into CIAs. These high default penalties for failing to cooperate or meet policing and prevention duties, as well as the additional imposition of costly CIAs for noncompliant firms, will serve to increase the costs of noncompliance relative to the liability enhancement effects of policing and prevention measures.[214] These reforms would effectively expand and strengthen the use of CIAs and analogous procedures such as the HHS-OIG's Provider Self-Disclosure Protocol, albeit with a more concrete and delineated approach that would apply to any FCA corporate defendant, not just in the healthcare context.[215] The adoption of effective and mandatory FCA corporate cooperation guidelines will go a long way toward optimizing the FCA's enforcement framework.

C. Publicly Filed Settlements with Admissions[216]

This last reform requires a paradigm shift in the way that the DOJ currently approaches resolution and settlement under the FCA. The DOJ should require that all FCA settlements be publicly filed as consent orders in federal district court and should require noncooperating corporations to admit to violative conduct.[217] These provisions will undoubtedly alter the enforcement calculus for both potential whistleblowers and corporate

212. *See* Mustokoff et al., *supra* note 181, at 32.

213. *See* Symchych et al., *supra* note 96, at 1, 6 ("Line-by-line consideration of each criterion in the [corporate liability] Memoranda forms a fairly uniform agenda throughout the country for the discussion of potential corporate criminal responsibility with federal prosecutors.").

214. *See supra* notes 136, 176–84 and accompanying text.

215. *See supra* notes 99–101 and accompanying text.

216. The debate over publicly filed settlements with admissions of wrongdoing has recently become a contentious topic. *See generally* Samuel W. Buell, *Liability and Admissions of Wrongdoing in Public Enforcement of Law*, 82 U. CIN. L. REV. 1 (2014).

217. *See supra* note 12 and accompanying text. The U.S. Attorney for the Southern District of New York has already largely instituted this requirement for publicly filed settlements with admissions of wrongdoing without sacrificing enforcement. *See* Gretchen Morgensen, *Making Them Pay (and Confess)*, N.Y. TIMES, Jan. 27, 2013, at BU1. For a representative sample of the admissions language used in these publicly filed settlements, see JONES DAY, ADMISSIONS OF WRONGDOING: THE FINAL FRONTIER (2013), *available at* http://www.jonesday.com/files/upload/Admissions%20of%20Wrongdoing.pdf.

defendants, leading to increased cooperation from defendants and a decrease in frivolous and marginal qui tam suits in the long term.

A settlement regime which requires publicly filed settlements and admissions of liability undoubtedly raises the stakes for corporate defendants. Publicly filed settlements come with much more stigma, media attention, and negative consequences for corporate defendants.[218] Where corporations fail to meet their policing and prevention duties or do not fully cooperate with the government, they should be required to admit to FCA-violative conduct in any settlement. These admissions will also engender and strengthen follow-on civil litigation brought by private litigants against corporate defendants.[219] The prospect of reputational harm and follow-on litigation provide a higher "default penalty" that effectively increases firms' expected liability for noncompliance and incentivizes firms to adopt policing and prevention measures and to fully cooperate with government investigations.[220]

The adoption of this settlement regime should also lead to the filing of fewer frivolous qui tam actions by the relators' bar over the long term. Requiring publicly filed settlements with admissions of wrongdoing functions as a form of "merits review" that would serve to alleviate concerns regarding frivolous and nonmeritorious filings.[221] Potential whistleblowers and their attorneys who would otherwise file frivolous or marginal claims in the hopes of extracting a nuisance settlement will be deterred from filing cases where they will need to sufficiently substantiate allegations before settlement. Such a requirement also alters the settlement calculus for corporate firms, disincentivizing them from discreetly settling marginal or frivolous FCA matters for nuisance value.[222] Rather than face the added costs of reputational harm and possible follow-on civil litigation, corporate defendants will likely choose to litigate a wider cross-section of cases.[223] And, under the current FCA framework, the DOJ should be able

218. *See* Buell, *supra* note 216, at 8–10.

219. *See* Morgensen, *supra* note 217 ("These admissions not only bring much-needed accountability in such matters. They can also help private plaintiffs overcome some of the hurdles they face when bringing cases."); *see also* David McAfee, *Flagstar Execs Hit with Investor Suit over $133M FCA Deal*, LAW360 (Jan. 24, 2014, 8:15 PM), http://www.law360.com/articles/503792/flagstar-execs-hit-with-investor-suit-over-133m-fca-deal (reporting on a follow-on shareholder derivative suit filed against former directors of Flagstar Bancorp based on admissions of wrongdoing in prior FCA settlement agreement).

220. *See* Arlen & Kraakman, *supra* note 129, at 727.

221. This proposal functions in similar ways to the mandatory summary judgment model proposed as a general solution to nuisance value settlements. *See* Randy J. Kozel & David Rosenberg, *Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment*, 90 VA. L. REV. 1849, 1860 (2004).

222. *See supra* notes 189–91 and accompanying text.

223. *See* Andrew Schilling, *DOJ Increasingly Pursuing Both Monetary and Non-Monetary Relief in Civil Enforcement Actions*, 26 J. White-Collar Crime (Westlaw) No. 12, at *2 (Sept. 2012) ("If DOJ insists upon admissions of misconduct in settling civil fraud

to enforce this settlement regime even in cases in which it declines to intervene.[224] Faced with the prospect of actually having to litigate and bring more marginal cases to trial, the relators' bar will be more discerning in the quality of cases it pursues. In the long run, fewer frivolous and marginal claims will be filed.

These requirements will undoubtedly lead to an increase in litigation costs for firms in the short-term; however, in the long term, the filing of frivolous suits will be deterred and the decrease in litigation costs associated with those frivolous cases will serve to offset those initial costs. Additionally, the litigation of borderline cases will help to better delineate the boundaries of FCA liability for corporate defendants and potential relators alike. Targets of FCA actions will be induced to bring more cases to trial that are at the margin, rather than settle and admit to liability. The decisions that courts hand down in these marginal cases will better define the boundaries of FCA liability going forward, making corporate determinations of whether conduct constitutes a violation easier and more concrete, consequently reducing costs associated with the uncertainty of whether conduct may give rise to FCA liability.

CONCLUSION

The FCA qui tam provisions represent an important and effective tool designed to protect the government from fraud. The evolution of these qui tam provisions has had important effects on government-whistleblower and government-defendant relationships. Analyzing the agency costs of these relationships provides a principled method for determining the distinct advantages and disadvantages involved with qui tam actions. The DOJ can easily take steps to address the potential downsides of qui tam enforcement without the need for legislative fixes. Accordingly, clearly delineating incentives for relators and their counsel, formally establishing clear guidance for corporations seeking credit for cooperation, and requiring publicly filed settlements with accompanying admissions of liability will help ameliorate the inefficiencies, and strengthen the benefits, of the FCA qui tam provisions.

---

cases, more defendants may conclude that the cost of litigating—often cited as the most compelling reason to settle—could be lower than the costs of settling.").

224. *See* Engstrom, *supra* note 87, at 1271–72 ("[T]he FCA aims to mitigate concern about private overenforcement by granting the Attorney General—and, by further delegation, the DOJ's Civil Fraud Section—substantial authority to oversee and control qui tam litigation. Thus, the DOJ may dismiss or settle a qui tam case out from under a private relator, subject only to a basic fairness hearing."). There is a split among circuit courts that have addressed the issue over whether the United States possesses a veto over privately negotiated FCA settlements absent intervention. *Compare* United States v. Health Possibilities, P.S.C., 207 F.3d 335, 339 (6th Cir. 2000) (relator may not voluntary dismiss qui tam action without government's consent), *and* Searcy v. Philips Elecs. of N. Am. Corp., 117 F.3d 154, 159 (5th Cir. 1997) (same), *with* United States *ex rel.* Killingsworth v. Northrop Corp., 25 F.3d 715, 722 (9th Cir. 1994) (government only entitled to fairness hearing of privately negotiated FCA settlement).