The *False Claims Act and Qui Tam Quarterly Review* is published by the Taxpayers Against Fraud Education Fund. This publication provides an overview of major False Claims Act and *qui tam* developments including case decisions, DOJ interventions, and settlements.

The TAF Education Fund is a nonprofit charitable organization dedicated to combating fraud against the Federal Government through the promotion and use of the *qui tam* provisions of the False Claims Act (FCA). The TAF Education Fund serves to inform and educate the general public, the legal community, and other interested groups about the FCA and its *qui tam* provisions.

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Whistleblowers and *Qui Tam* for Tax[1]

Dennis J. Ventry, Jr.

1. Originally published as Dennis J. Ventry, Jr., *Whistleblowers and* Qui Tam *for Tax,* 61 The Tax Lawyer 357 (Winter 2008)

FROM THE EDITOR

By the time you read this, American voters will have elected a new President, and that President will already be in the process of putting his imprint on the United States Department of Justice. In addition, several key Congressional races will have recently been decided, as well as numerous state elections. The False Claims Act will certainly be affected by all of this change, as both houses of the 111th Congress will consider pending amendments to the federal False Claims Act, many state lawmakers will consider measures to enact or amend their respective state False Claims Act legislation, and *qui tam* relators and their counsel will potentially begin working with a new Justice Department—and its staff of new government lawyers—which may or may not have new policies, strategies and agendas for False Claims Act litigation.

Amid all of this change, this publication is experiencing significant transformations as well. The principal change is that Jeb White, Taxpayers Against Fraud's President & CEO, will no longer serve as editor-in-chief of the False Claims Act & *Qui Tam* Quarterly Review. I'm taking over that role. So allow me to introduce myself. My name is Cleveland Lawrence III, and since the start of the year I've served as TAF's Staff Attorney and Director of Legal Education. While I'm certainly not the most experienced legal practitioner, I spent nearly seven years as a litigator, and had many opportunities to work on False Claims Act litigation. I should mention that I spent much of my legal career as a defense attorney, and that I've defended clients against False Claims Act allegations, so I bring a unique perspective to this practice area and to this publication. As I continue to grow in knowledge and experience, I hope to become a resource that you can rely on. I can be reached at clawrence@taf.org.

In addition to this personnel change, the Quarterly Review is undergoing some other changes as well. As TAF hopes to be the most up-to-date source of False Claims Act news and information, we will circulate case summaries online, on a bi-weekly basis. No longer will you have to wait until the end of each quarter to read these summaries. In addition, to cut costs and to make the publication more accessible to our readers, we will publish the Fall, Winter and Spring editions of the Quarterly Review online, and each Summer, we will publish a hard copy "Year In Review" edition, which will include all of the information contained in the online editions. If you would prefer to receive a hard copy of every edition of the Quarterly Review, let me know, and we'll make arrangements to get hard copies to you.

Finally, it is my goal that the Quarterly Review accurately reflects you, the False Claims Act practitioners, *qui tam* relators, government attorneys, and others who comprise our readership. Ultimately, I hope that you will feel a sense

of ownership in the Quarterly Review, and not view it solely as a source of information. To that end, I encourage you to contact me with your articles, your ideas and your suggestions about ways to improve the publication. I look forward to hearing from you.

Sincerely,
Cleveland Lawrence III
clawrence@taf.org

Recent False Claims Act & *Qui Tam* Decisions

JULY 1, 2008–SEPTEMBER 30, 2008

FALSE CLAIMS ACT LIABILITY

A. Violations of the Anti-Kickback Statute and/or Stark Law

U.S. ex rel. Pogue v. Diabetes Treatment Centers of America, 2008 WL 2791687 (D.D.C. July 21, 2008)

A relator filed a suit against a medical treatment center alleging that the center presented false Medicare and Medicaid claims to the government, in violation of the FCA, the Anti-Kickback Statute and the Stark Law. The center moved for summary judgment related to various aspects of the AKS and Stark Law claims under the FCA. The United States District Court for the District of Columbia denied the motion in part and granted it in part, holding that AKS and the Stark Law violations could lead to liability under the FCA, and also finding that the relator produced sufficient evidence of a FCA violation, as it related to the AKS claim. However, the court found that the relator failed to meet the requisite elements of a Stark Law violation.

The relator claimed that defendant medical treatment center knowingly and willfully caused false Medicare claims to be submitted to the government, in violation of the FCA, the AKS and the Stark Law. The center moved for summary judgment, claiming that violations of the AKS and Stark Law could not proceed under the FCA as a matter of law and arguing, in the alternative, that the relator failed to prove the necessary elements of AKS and Stark Law violations. The court held as an initial matter that AKS and Stark Law violations can be brought under the FCA, since compliance with the AKS and Stark is a condition for Medicare reimbursement, and when defendants submit claims to Medicare, they impliedly certify compliance with these laws.

Additionally, the court denied the summary judgment motion related to the AKS. The court concluded that it was not necessary for the relator to produce evidence of each allegedly false claim submitted to the government, as long as the relator could highlight sufficient evidence of claim submission generally. Although the relator failed to produce evidence showing that Medicare claims had been presented to the government by hospitals with which the defendants had contracts, the relator did produce a declaration from an official working for Medicaid, which showed that the center caused Medicaid claims to be presented to the government. The court also found that the relator produced sufficient circumstantial evidence to support its argument that the center remunerated physicians with a purpose to induce referrals. Pointing to evidence that the defendant paid its medical directors fees far in excess of the fair market value

commensurate with their duties, that the foundation of the defendant's business model was built primarily on concerns about the number of patients treated on a particular day, that the defendant was focused on referral numbers when negotiating with medical directors and hospitals, as well as some other "smoking guns," the court concluded that a reasonable jury could decide the issue in relator's favor. Furthermore, the court found that the relator produced sufficient evidence regarding the defendant's reckless disregard or knowledge of available information related to its potential AKS violation. The court found that the evidence was sufficient for a reasonable jury to find that the defendant acted with the required level of culpability to impose AKS and FCA liability. As a result, the court denied the center's motion with respect to the relator's AKS claim.

However, the court found that the relator failed to prove the necessary elements of a Stark Law violation and granted defendant's motion with respect to that claim. The court determined that the relator failed "to produce sufficient evidence showing that contracting hospitals had the requisite knowledge of defendant's payment scheme," and only made conclusory allegations regarding the alleged Stark violation.

B. What Constitutes a "False" Claim

U.S. ex rel. Loughren v. Unumprovident Corp., 2008 WL 4280133 (D. Mass. Sep. 15, 2008)

The relator brought a *qui tam* action against a company providing employee benefits and its subsidiary, in the United States District Court for the District of Massachusetts. The relator alleged that the defendants conspired to require many of their insureds to file false claims for disability benefits from the Social Security Administration (SSA). The defendants moved for summary judgment, arguing that since the SSA welcomed all claimants, even if they were unsure whether they qualified for benefits, the submission of a claim could not be a false claim under the FCA. The court disagreed, however, and held that the defendants had a duty to be truthful with the SSA and that the relator's evidence regarding the submission of false claims was disputed and improper for a summary judgment decision. The court also allowed the conspiracy claim, in part, for the period when the defendants were not corporate affiliates.

U.S. v. Stevens, 2008 WL 4146666 (W.D. Ky. Aug. 29, 2008)

The government filed a suit in the United States District Court in the Western District of Kentucky against a doctor, his wife, his clinic, his father-in-law, his mother-in-law, and a company formed by his in-laws, alleging that the defendants defrauded the government by submitting Medicare claims under a wrong billing code ("CPT Code 95937") for reimbursement in violation of FCA sections 3729 (a)(1)-(3). The action arose out of the doctor's billings regarding a device called a Matrix machine. After his initial claims for reimbursement were denied, his father-in-law took control of the doctor's clinic's billing. After a meeting with a governmental employee regarding billing matters, the claims for treatment from the Matrix machine began to be paid. Eventually, the doctor's in-laws formed a corporation to handle all of the clinic's billing. The doctor never reviewed his in-laws' billing practices. The Kentucky Board of Medical Licensure investigated the clinic's billing and found improper billing practices. The government's FCA action followed. The government moved for partial summary judgment regarding the CPT Code 95937 FCA claim. The court granted the motion, finding that the doctor acted with reckless disregard as to the truth or falsity of the claims submitted for reimbursement, since he never took any reasonable steps to ensure that his billings were correct. The court also awarded $863,769 to the government as the doctor's wife and his father-in-law did not dispute liability. The court finally declined to address the unjust enrichment claims.

Falsity Element

The court concluded that there were no issues of fact related to whether the claims submitted using the alleged wrong billing code were false because there was no evidence to show that the use of the alleged wrong billing code was appropriate. The defendant doctor argued that the billings were not false claims as Medicare allegedly told his father-in-law that it was proper to bill the Matrix machine in the manner in which he did. However, the court observed that the doctor did not have first hand knowledge of what Medicare told his father-in-law. Furthermore, the court held that the argument was not sustainable in light of the father-in-law's admission that he knowingly and intentionally submitted false claims.

Knowledge Requirement

The court then discussed whether the doctor had knowledge of the fraud and held that knowledge could be shown by reckless disregard of the truth or falsity of the information instead of proof of specific intent. The court's finding that the doctor completely gave control of his billing to a person with no prior medical billing experience was enough to satisfy the court that he acted with reckless disregard of the truth or falsity of the billings. Indeed, the court observed that there was no evidence to suggest that the doctor did anything to make sure his billings were correct. Hence, the court granted summary judgment in favor of the government.

U.S. ex rel. Rose v. East Texas Med. Ctr. Reg. Healthcare Sys., 2008 WL 4056601 (E.D. Tex. Aug. 25, 2008)

The relator brought a *qui tam* action against a hospital conglomerate and a private hospital facility, alleging that the defendants violated the False Claims Act by masquerading as a rural public hospital in order to fraudulently receive additional Medicaid matching funds from the government through the intergovernmental transfers ("IGT") procedure for the Medicaid Upper Payment Limits ("UPL") Program. The relator alleged that the defendants obtained over 15 million dollars of federal Medicaid matching funds in violation of the FCA. The case was filed in the United States District Court for the Eastern District of Texas and the government declined to intervene. The defendant moved for summary judgment. The court determined that although both parties thoroughly briefed the issue of whether the defendant was a rural public hospital under the applicable federal law, it was not necessary to decide the issue substantively. Instead, the court relied on the Fifth Circuit's recent decision in *U.S. v. Medica Rents*, No. 03-11297 (5th Cir. August 19, 2008)—summarized herein—and held that the only issue it needed to decide was whether the evidence was sufficient to raise

a genuine issue that the defendant hospital knowingly made a false claim to the government. Because of the defendant's reliance upon a government entity's advice and the lack of clarity in the applicable law, the court found that the defendant could not have knowingly submitted a false or fraudulent claim. Tellingly, the relator's own expert was unable to say definitively that the defendants acted improperly. At most, the court found that the defendant's actions amounted to negligent behavior, which, it held, cannot support an FCA claim. Accordingly, the court found that there was no genuine issue of material fact as to whether the defendants acted knowingly with respect to their UPL claims. Thus, the court granted the defendants' motion for summary judgment and dismissed the case with prejudice.

U.S. v. Medica Rents Co. Ltd., 2008 WL 3876307 (5th Cir. Aug. 19, 2008)

The relators filed a *qui tam* action against a medical equipment rental company that rented special kinds of mattress overlays called ROHOs and then submitted reimbursement claims to Medicare in each state where it did business. Beginning in 1992, the defendant began to receive conflicting information regarding how to correctly code the mattresses for billing—the defendant received instructions from various state Medicare programs and the Health Care Financing Administration to bill under one code, while other states and various federal agencies gave instructions to bill under a different code, which was more lucrative for the defendant. The relators alleged that the defendant had knowingly overbilled for ROHOs in violation of the FCA. In addition, the government had filed another action against the defendant for common law claims of mistaken payment and unjust enrichment. The two actions were consolidated and brought before the United States District Court for the Northern District of Texas. The district court granted summary judgment for the defendants on the FCA claim and the common law claims and awarded $4.8 million in attorneys' fees pursuant to the Equal Access to Justice Act ("EAJA"). On appeal, the United States Court of Appeal for the Fifth Circuit affirmed the decision of district court on the FCA claim, holding that since there was substantial confusion about which code to use due to contradictory instructions and guidance, it could not be inferred that the defendant knowingly submitted false or fraudulent claims. In addition, the appeals court affirmed the district court's decision on the government's common law claims regarding mistaken payment and unjust enrichment because the government itself had authorized use of the more lucrative billing code. The court also reversed the award of attorneys' fees because of the legitimate confusion about the correct billing code apparent in the facts which precluded a finding of bad faith on the part of the government's claims.

U.S. ex rel. Gudur v. Deloitte & Touche, 2008 WL 3244000 (5th Circuit Aug. 7, 2008)

Relator filed a *qui tam* action in the United States District Court for the Southern District of Texas against an accounting management firm and an insurance company, in which he alleged FCA violations arising from the defendants' alleged inflation of the reimbursement rates for services rendered to Medicare-eligible students. The district court dismissed the defendant insurance company from the suit and granted the other defendant's motion for summary judgment. The district court also excluded one of the relator's expert witnesses. In addition, the district court denied the relator's motion for partial summary judgment. The relator appealed to the United States Court of Appeals for the Fifth Circuit. However, the Fifth Circuit affirmed the district court's decision, holding that the relator failed to establish falsity, knowledge or intent under the FCA. The court also affirmed the district court's dismissal of the defendant insurance company from the case and held that the relator failed to state a claim against that defendant since he did not plead with specificity and instead relied on the occasional use of the generic term "defendants."

U.S. ex rel. Roberts v. Aging Care Home Health, Inc., 2008 WL 2945946 (W.D.La. July 25, 2008)

Defendants—a home health service provider and its hospital's CEO—are alleged to have violated the FCA by submitting false claims to Medicare. Initially, the government sought partial summary judgment against the defendants, and the United States District Court for the Western District of Louisiana granted that motion. The government then filed an Amended Complaint which alleged that the home health service provider's CFO also violated the FCA. Subsequently, the government moved for partial summary judgment against the CFO as well. The government contended that the CFO was estopped from contesting the court's previous rulings against the CEO and the home health service provider, and argued that the CFO was liable under the FCA when he submitted, or caused to be submitted, false cost report certifications and claims after he knew that the home health service provider was in violation of the Stark Statute. The CFO opposed the government's motion in part. While he did not oppose the collateral estoppel argument, he argued that the government did not present sufficient evidence against him, since it allegedly did not show that the cost certifications he signed were material to the payments made by Medicare. The court granted the government's motion in part and denied it in part. The court granted the government's motion with respect to its claims under FCA sections 3729(a)(1) and (a)(2), after determining that the CFO had sufficient knowledge or reckless disregard of the truth to warrant FCA liability, and that the govern-

ment provided sufficient evidence that the CFO signed the cost certifications in order to get Medicare to pay the home health service provider. However, the court denied the government's motion with respect to its claims under FCA section 3729(a)(7), holding that the government failed to show that the CFO concealed an obligation to pay the government.

The government alleged that the CFO of Aging Care Home Health, Inc. (a home health service provider) violated FCA sections 3729(a)(1), (a)(2), and (a)(7), by acting with knowledge, or reckless disregard of the truth, when he submitted, or caused to be submitted, false cost report certifications and claims after he knew that Aging Care was in violation of the Stark Statute. Since the government had already been granted summary judgment after filing an initial complaint alleging the same claims against Aging Care and its CEO, the government argued that collateral estoppel (a/k/a issue preclusion) Aging Care's CFO from contesting liability on those claims. As a result, the government moved for partial summary judgment on its claims against the CFO. The court granted the government's motion with respect to the government's claims under FCA sections 3729(a)(1) and (a)(2), but denied the motion with respect to the claims under FCA section 3729(a)(7).

Collateral Estoppel

Even though the CFO was not a successor in interest of Aging Care, the court still found that issue preclusion was properly applied against him. The CFO was a 50-percent shareholder in Aging Care, and retained the attorneys that represented the defendants in the earlier action. The court found that, although the government did not seek summary judgment against the CFO in its earlier actions, the judgment was sought against the CFO's corporation, and the CFO had control of the litigation. The court also determined that the CFO's interests were adequately represented since Aging Care had the opportunity to defend against the earlier motions. Therefore, the court held that collateral estoppel was applicable.

Government's Motion For Partial Summary Judgment On FCA Section 3729 (a)(1) Was Granted

Only home health service providers (HHAs) and physicians can violate the Stark Statute. However, the court had previously found that Aging Care violated the Stark Statute when it fraudulently billed Medicare. Aging Care's CFO signed four of the five cost certifications, therefore the court found that he presented or caused to be presented a fraudulent or false claim for payment. The court determined that the CFO had reckless disregard or sufficient knowledge of the truth under the FCA, since he personally attended training related to Medicare billing requirements. Therefore, the court granted the government's motion for partial summary judgment on its claims under FCA section 3729(a)(1).

Government's Motion For Partial Summary Judgment On FCA Section 3729 (a)(2) Was Granted

The court first recognized that under section 3729(a)(2), there can be liability when a defendant intends to get a request approved or paid by the government, and originally makes a demand or request to a grantee, contractor, or other recipient of federal funds, which is subsequently forwarded to the government. Thus, the government was required to produce evidence that the CFO knew that the information in the Medicare claims at issue was fraudulent or false, and that his purpose in using or making the alleged false statements contained in those claims was to get the government to pay or approve a them. The court found that the government provided sufficient evidence that the CFO recklessly disregarded, or had actual knowledge of, the fact that Aging Care violated Stark, and that he signed cost certifications for the purpose of getting Medicare to pay Aging Care. Therefore, the court granted the government's motion for partial summary judgment with respect to the claims under FCA section 3729(a)(2).

Government's Motion For Partial Summary Judgment On FCA Section 3729 (a)(7) Was Denied

The court determined that the government failed to produce evidence against the CFO that showed that he concealed an obligation to pay or transmit money to the government. Accordingly, the government's Motion for Partial Summary Judgment under FCA section 3729(a)(2) was denied.

Damages

The court ordered the defendants to pay three times the amount of the single damages (for a total of $1,282,511.64) and imposed a fine of $5,500 for each of the 615 false claim alleged (for a total of $3,382,500.00).

U.S. ex rel K&R Limited Partnership v. Massachusetts Housing Financing Agency, 2008 WL 2651088 (D.C. Cir. July 8, 2008)

The D.C. Circuit affirmed the D.C. District Court's grant of summary judgment in favor of the defendant, MassHousing, a HUD mortgage lender. MassHousing sold tax-exempt bonds to investors, and used the proceeds of those bonds to finance affordable housing projects. MassHousing received low-interest housing payments from low-income housing owners, and sought reimbursement from HUD for the difference. In this *qui tam* action, the relator, K&R, alleged that MassHousing violated the FCA by using the proceeds from the sale of bonds to refund the higher interest bonds it used to finance its loans, including loans from which it received payments from HUD. K&R alleged that MassHousing knowingly miscalculated subsidy

payments it was receiving from HUD, since MassaHousing failed to pass along savings to HUD, by not reducing its claims for payment. The D.C. District Court granted summary judgment in favor of MassHousing and K & R appealed. After finding that both parties had offered up plausible interpretations of the applicable agreements and regulations, the D.C. Circuit Court determined that K&R could not show that MassHousing had the requisite intent to "knowingly" submit false claims to HUD. The court noted that the defendant's interpretation was not unreasonable, that it had voluntarily disclosed the questionable transactions to HUD, and that HUD did not express any concerns about the transactions but continued to pay the defendant, even after the relator filed its lawsuit. The court concluded that the lender "merely urges a different reading of the [claims], which here falls far short of showing a genuine issue as to whether [it] knew its claims were false." As a result, the court affirmed the district court's grant of summary judgment in favor of MassHousing.

See *U.S., ex rel. Ramadoss v. Caremark Inc.*, 2008 WL 3978086 (W.D.Tex. Aug. 27, 2008), at page 23.

JURISDICTIONAL ISSUES

U.S. ex rel. Bane v. Lincare Holdings, Inc., 2008 WL 2856893 (M.D. Fla. July 22, 2008)

Relator filed an FCA action against a laboratory, alleging that the lab schemed to defraud the government by getting false Medicare claims paid. The lab filed a motion for judgment on the pleadings, asserting that the relator failed to establish subject matter jurisdiction, failed to plead compliance with FCA section 3730(b)(2), and failed to plead a cause of action under FCA section 3729(a)(2). The motion was referred to a magistrate judge, who recommended that the laboratory's motion be denied. The district court adopted the magistrate's recommendation and denied the defendants' motion.

Relator Ben Bane filed an action in the U.S. District Court for the Middle District of Florida, alleging that Life Care Diagnostics (a laboratory) fraudulently bundled laboratory tests by mixing reasonably necessary tests with unnecessary tests, and then sought payment from Medicare for the tests, which resulted in Medicare paying for redundant and medically unnecessary services. The laboratory filed a motion for judgment on the pleadings, arguing that FCA sections 3730(b) and 3732(a) do not confer subject matter jurisdiction, only personal jurisdiction. In addition, the lab argued that Bane failed to file the required disclosure statement with the government, and failed to plead a cause of action. The motion was referred to a magistrate judge, who determined that the FCA does confer subject matter jurisdiction, since federal courts have federal question jurisdiction over FCA claims. The magistrate also determined that even though Bane filed his *qui tam* action before providing a disclosure statement to the government, the FCA "allows a relator to file suit *before* informing the government of the basis of the suit to avoid the risk of the government filing suit first and depriving the relator of his right to sue." Finally, the magistrate concluded that Bane provided the court with sufficient documentary evidence to support his claims. Therefore, the magistrate recommended that the district court deny the lab's motion. The district court adopted the magistrate's recommendation, and the defendant's motion was denied.

A. Section 3730(B)(5) First-to-File Bar

In re Pharmaceutical Industry Average Wholesale Price Litigation, 2008 WL 2778808 (D. Mass July 15, 2008)

Defendant, a laboratory, filed a motion to dismiss the plaintiff's complaint, *inter alia,* for lack of subject matter jurisdiction under the first-to-file bar of FCA section 3730(b)(5). The United States District Court for Massachusetts denied the motion, and held that the complaint did not contain allegations relating to the specific drug Erthromycin. Defendant moved for certification of an immediate appeal under 28 U.S.C. section 1292(b). Defendant claimed that Plaintiff had already brought a related action, and that the current action was barred by the FCA's first-to-file bar. Defendant alleged the court mistakenly applied an "identical facts" test to the first-to-file bar provision. The court denied the defendant's motion. The court found that the failure to specify Erythromycin in the earlier action constituted a failure to state all the essential facts under the "same material elements" standard in established case law. Therefore, plaintiff's complaint was allowed to stand.

Plaintiff, Ven-A-Care, filed a suit against a number of drug manufacturers (including the defendant in the present case, Abbott Laboratories, Inc.) in the Southern District of Florida, alleging Medicare and Medicaid fraud. In the Florida Case, plaintiff alleged that the defendants reported inflated, false, and fraudulent cost and price information of certain pharmaceutical products. Ven-A-Care subsequently amended its complaint by adding allegations regarding numerous drugs and National Drug Codes ("NDCs") for product using Erythromycin, a drug manufactured by Abbott. Plaintiff filed a similar complaint in the present case, in the District of Massachusetts, against several pharmaceutical companies, and amended that complaint to add Abbott as a defendant. That Massachusetts complaint also added several NDCs for Erythromycin products. Plaintiff then twice amended its Massachusetts complaint, adding additional allegations regarding NDCs for Erythromycin products. The Government intervened in the portion of the Florida Case that alleged Medicaid and Medicare fraud on the part of defendant, but the Government's intervention did not include claims involving Erthromycin products. Plaintiff then amended its complaint in the Florida Case, by adopting the Government's complaint-in-intervention and dropping the Erythromycin products claims. The Judicial Panel on Multidistrict Litigation consolidated the Florida Case with the Massachusetts Case into the present multi-district litigation.

Plaintiff severed its Erythromycin products claims as to Abbott, filed the present complaint against Abbott, and moved to transfer that complaint to the multi-district litigation. Plaintiff's motion to transfer its amended severed complaint was granted. Abbott then moved to dismiss the severed complaint regarding Erythromycin products claims, alleging that the False Claims Act's first-to-file bar prevented that action. The court denied that motion and Abbott

moved for certification of an immediate appeal under 28 U.S.C. section 292(b). The court denied that motion as well, holding that the "same material elements" standard, not the "identical facts" standard applies when determining whether the first-to-file bar applies. Applying that standard, the court found that since the plaintiff's complaint in the Florida case did not specify Erythromycin, then that complaint "did not provide the government with notice of the essential fact that the alleged fraudulent scheme involved Erythromycin." Therefore, the plaintiff's Florida complaint did not state all the essential facts under the "same material elements" standard, the first-to-file bar did not bar the plaintiff's severed complaint in the Massachusetts case, and thus, the defendant's motion for a certification of an immediate appeal was denied.

B. Section 3730(e)(4) Public Disclosure Bar and Original Source Exception

U.S. ex rel. First American Engineered Solutions, LLC v. Olin Corp., 2008 WL 4224350 (E.D. Wis. Sep. 11, 2008)

Plaintiff filed an action in the United States District Court for the Eastern District of Wisconsin, alleging FCA violations and contractual claims against an ammunition manufacturing corporation. The complaint involved a contract where the plaintiff was an authorized distributor for ammunition manufactured by the defendant to the Department of Homeland Security ("DHS"). The plaintiff claimed that the defendant violated the FCA by fraudulently delivering defective and nonconforming goods to the DHS. The plaintiff was informed about the government's rejection of the goods by a Federal Contracting Officer, after which the plaintiff's complaint was filed. The defendant moved to dismiss the claims under the FCA because the plaintiff was not the original source of the information in the complaint. The court granted the motion to dismiss.

Public Disclosure Bar Applied To The Plaintiff's Claim

The court held that the plaintiff's FCA claims were based on a public disclosure, finding that the information underlying the FCA claim was not only discovered by the government but it was disclosed to the plaintiff by the government itself. Indeed, the complaint explicitly stated as much. Finally, nothing indicated that the plaintiff was in any way an original source of the information. Hence, the court dismissed the FCA claim.

Government's Approval For Dismissal Not Required

The plaintiff argued that *qui tam* actions can not be dismissed without the government's approval under § 3730(b)(1). The court rejected that argument and held that this section under 3730(b)(1) only applies in voluntary dismissals.

U.S. ex rel. Maxwell v. Kerr-McGee Oil & Gas Corp., 2008 WL 4149638 (10th Cir. Sep. 10, 2008)

The Tenth Circuit Court of Appeals overturned a Colorado district court's determination that it did not have subject matter jurisdiction over an FCA claim. In the underlying case, the plaintiff alleged that the defendant, an oil and gas producer, defrauded the government by underpaying royalties for federal offshore oil leases. After trial, the jury awarded damages of $7.5 million but, before entering judgment, the district court reversed its prior ruling on the issue of subject matter jurisdiction and determined that the

information underlying the suit had previously been disclosed to the public by an e-mail exchanged between a state employee and an agent of Minerals Management Service ("MMS"), thereby removing jurisdiction under the "public disclosure bar" provision of FCA section 3730 (e)(4). The Tenth Circuit reversed. First, it held that a government employee may properly act as a relator. Second, it held that the transfer of information between a federal employee and a state government auditor who was under a duty of confidentiality was not a public disclosure and therefore did not deprive the district court of subject matter jurisdiction. Finally, the appellate court held that the plaintiff's allegations were not based upon information publicly disclosed by any prior litigation. The court overturned the district court's dismissal of the case for lack of subject matter jurisdiction and remanded the matter for further proceedings.

Government Employee As Relator

The court concluded that the plaintiff was not prevented from serving as a relator simply because he was a federal auditor who discovered the information underlying his FCA claim in his official governmental role. It observed that the 1986 FCA amendments intended to encourage more private enforcement suits by providing more permissive jurisdiction limitations. The defendant, in an attempt to distinguish recent Tenth Circuit precedent, contended that government employees could only be relators if they discovered fraud while not acting within their official capacity. The court rejected this argument and held that government employees can be relators as long as there is not a public disclosure of the information underlying their claims.

Public Disclosure

The court then held that the transfer of information to a state government employee who was under a duty of confidentiality with respect to that information was not a "public disclosure" under the FCA. The court interpreted "public disclosure" as the release of information such that the information was generally available and not subject to confidentiality. Since the email exchange between the state government employee and the MMS agent was subject to confidentiality, it was not a "public disclosure" that would deprive the courts of jurisdiction over the plaintiff's suit. The court further stated that this interpretation was consistent with the intent of the 1986 amendments to encourage private citizen suits and limitation of civil actions by opportunists acting only upon public information.

Prior Litigation Was Not A Public Disclosure

Finally, the court held that the plaintiff's suit was not based on information which was publicly disclosed in the course and settlement of prior litigation

in which the defendant was a party. The court observed that the publicly filed documents in the prior litigation did not mention the facts in the case at bar and that the alleged fraud took place after the prior litigation ended. Further the court held that general allegations that the defendant was involved in fraud were not sufficiently specific to constitute a public disclosure because it was not in itself enough information to discover related frauds.

U.S. ex rel. Lam v. Tenet Healthcare Corp., 2008 WL 2835215 (5th Cir. July 22, 2008)

Relators appealed the district court's order granting summary judgment in favor of the defendant. The district court held that the public disclosure bar prohibited the relators's suit, since they did not qualify as original sources under FCA section 3730(e)(4). The Fifth Circuit found that the relators' allegations were based on publicly disclosed information and affirmed the district court's order for summary judgment in favor of the defendant.

Relators, Man Tai Lam and William Meshel, filed a *qui tam* action in the United States District Court for the Western District of Texas against the defendant, Tenet Healthcare Corporation, alleging that the defendant artificially inflated charges for services at two of its hospitals and consequently was able to qualify more patients as outlier patients and receive Medicare reimbursements that it was not entitled to. The Government declined to intervene. However, after the district court determined that the information contained in the relators' complaint had been publicly disclosed in a publication called the "Weakley Report," prior to the time the relators filed suit, both the Government and the defendant moved for summary judgment. The district court granted summary judgment in favor of the defendant and the Government, finding that the relators did not have direct and independent knowledge of the information on which their allegations were based. The relators appealed to the Fifth Circuit and the appellate court affirmed the district court's summary judgment decision.

Relators Were Not The "Original Sources" As Defined Under FCA Section 3730(e)(4)

After upholding the district court's finding that the allegations contained in the relators' complaint had been previously publicly disclosed, the Fifth Circuit turned to the question of whether or not the relators qualified as the original source of that information. The court held that an original source is one who has independent, direct knowledge of information on which the allegations are based, and noted that "direct" and "independent" have different meanings. The court stated that "direct" knowledge is obtained by the relator's first-hand efforts, and is not obtained through the labor of others, nor is it derived from the information of others. "Independent" knowledge, however, must not rely on

public disclosures. The defendant argued that the relators' information came from patient complaints. The circuit court observed that while the relators did examine a report of comparative charges, the report did not indicate the charges that would be required to establish the defendant's outlier fraud. The court found that the rest of the relators' supporting information was just as indirect. Therefore, the appellate court affirmed the summary judgment order.

See *Hopper v. Solvay Pharmaceuticals, Inc.*, 2008 WL 4177927 (M.D. Fla. Sep. 08, 2008), at page 40.

STATUTORY INTERPRETATIONS

A. Section 3730(b)(1) Government Consent for Dismissal

Ector ex rel U.S. v. Axia College Online, Wesetrn Int'l Univ., et al., 2008 WL 2704622 (D.D.C. July 7, 2008)

Plaintiff, Morsellor Ector, brought a *qui tam* action against defendants Axia College Online (an online university) and Apollo Group, its parent corporation, seeking to recover damages that arose from alleged false claims made by the defendants in violation of FCA section 3729. The United States declined to intervene in the case, and plaintiff filed a notice for voluntary dismissal. Pursuant to FCA section 3730(b)(1), the plaintiff's action could only be dismissed if the Attorney General and the court provided written consent to the dismissal, including reasons for consenting. The government consented to the voluntary dismissal but failed to state the reasons for its consent. Therefore, the United States District Court for the District of Columbia ordered the government to show cause as to why the plaintiff's case should be dismissed. The government confirmed that it had investigated the plaintiff's case and that it was not in the government's interest to pursue the litigation. The court reviewed the plaintiff's voluntary dismissal, along with the government's reasons for consenting to the dismissal and concluded that the requirements of FCA section 3730(b)(1) were satisfied. Thus the case was dismissed without prejudice to the United States.

Sherwood Brown v. Joseph Michael Sherrod, 2008 WL 2640441 (10th Cir. July 7, 2008)

Brown alleged that defendant Sherrod filed a false bankruptcy claim in violation of the FCA. The district court dismissed the complaint, finding that Brown failed to demonstrate that Sherrod requested or received payment from the government and there was no evidence that the government was a creditor in Sherrod's bankruptcy claim. Brown appealed the district court ruling, and alleged that the case was improperly dismissed, since the Attorney General did not consent. However, the Tenth Circuit affirmed the dismissal of Brown's complaint for failure to state a claim. Although section 3730(b) of the FCA provides that an action can only be dismissed if "the court and the Attorney General give written consent to the dismissal and their reasons for consenting," the appellate court found that the Attorney

General's consent was not necessary when the district court granted a defendant's motion to dismiss; instead, consent of the Attorney General is only required when a voluntary dismissal is sought by a plaintiff.

See *U.S. ex rel. First American Engineered Solutions, LLC v. Olin Corp.,* 2008 WL 4224350 (E.D. Wis. Sep. 11, 2008), at page 16.

B. Section 3729(a)(2) Presentment Requirement

See *U.S. ex rel. Ramadoss v. Caremark Inc.*, 2008 WL 3978086 (W.D.Tex. Aug. 27, 2008), below.

C. Section 3729(a)(7) Reverse False Claims

U.S. ex rel. Ramadoss v. Caremark Inc., 2008 WL 3978086 (W.D.Tex. Aug. 27, 2008)

The relator filed a *qui tam* action in the United States District Court for the Western District of Texas, alleging that a pharmacy benefit management company violated the reverse false claims provision of the FCA by applying restrictions contained in the health plans it administered to state Medicaid claims. The government intervened six years after the original complaint was filed, alleging violations of the FCA, negligent misrepresentation, common law recoupment and violations of state FCA and/or Medicaid statutes for the plaintiff states in the lawsuit. The *qui tam* action resulted in a multi-state litigation involving the federal government, the relator, and several states. The collective plaintiffs alleged that the defendant exploited situations in which dual eligibles—persons who qualified for Medicaid coverage but who also had third party health insurance plans—received prescription drugs. The plaintiffs alleged that the defendant's role, as a pharmacy benefit management company, was to process prescriptions and corresponding claims for its third party health plan clients, based on agreements the defendant had with its clients regarding which expenses the clients' respective health plans covered. The plaintiffs alleged that since Medicaid payments are a last resort, the defendant was only allowed to bill Medicaid for charges above and beyond what its clients were first obligated to pay, and that if Medicaid paid more than it should have paid, then the defendant's clients were to reimburse Medicaid for the overpayment. However, the plaintiffs alleged, the defendant unlawfully applied restrictions contained in its clients' health care plans in order to reduce or avoid their obligation to pay the government, and that these actions constituted FCA violations. Both sides moved for partial summary judgment.

With respect to the government's FCA claims, the defendant moved for summary judgment, arguing: (1) that the government's FCA claims on behalf of state Medicaid agencies failed because the defendant's statements rejecting or denying Medicaid claims for reimbursement were submitted to state Medicaid agencies, not the government; and (2) all of the government's FCA claims arising six years prior to its unsealed complaint-in-intervention were barred by the statute of limitations in the FCA. The government also moved for summary judgment on the FCA claims, arguing that: (1) the defendant owed the

government an "obligation" under the FCA; (2) the defendant was collaterally estopped from arguing that the various health plan restrictions defeated its obligation; and (3) allegedly false statements were made by the defendant to avoid reimbursing the government. The primary issues were whether the defendant could apply existing restrictions to reject a reimbursement request from a state Medicaid agency, VA or IHS and whether the defendant's application of its clients' health plan restrictions constituted a reverse false claim under the FCA. The court denied the defendant's motion for summary judgment on the issue of whether the alleged false claims must be presented to the government. However, the court granted the defendant's motion for summary judgment and denied summary judgment for the government with respect to the falsity and obligation elements and the statute of limitations issue.

Presentment Requirement

The court noted that in light of the Supreme Court's decision in *Allison Engine Co. v. United States ex rel. Sanders,* there is no presentment requirement under section 3729 (a)(2) of the FCA. The defendant contended that the government was barred from asserting FCA claims on behalf of state Medicaid agencies because none of the alleged false statements involving state Medicaid were submitted to the government. The government argued that presentment was not a prerequisite for liability under the reverse false claims provision of the FCA. The government asserted that even if the court found that presentment was a requirement to FCA liability, the government's claims were still valid because presentment could occur directly or indirectly. However, the court did not find it necessary to resolve the presentment issue as the court later found pursuant to FCA section 3729(a)(7) that the defendant company did not owe an "obligation" to the government in regard to denials of reimbursement requests submitted to state Medicaid agencies. Thus the government could not establish FCA liability to the government on behalf of the state Medicaid agencies.

Falsity Element

In analyzing the FCA claims, the court only discussed two issues under section 3729(a)(7): falsity and obligation. The court's discussion of falsity centered upon the correct application of *Caremark, Inc. v. Goetz,* 395 F.Supp.2d 683 (M.D.Tenn. 2005). That case discussed to what extent plan restrictions can be applied to state Medicaid claims. It held that procedural restrictions were inapplicable to Medicaid claims but substantive restrictions were applicable. Using this distinction as a springboard and recognizing the unsettled status of the law regarding this issue, the court found that the government could not establish that the defendant company made a "false record or statement" before the *Goetz* decision. First, because the restrictions actually existed as part of the plans the defendants administered, they were not objectively false. Of course, the court

observed, this defense fails if the restriction has been deemed impermissible by statute or case law. Thus, the court then determined that there were legitimate grounds for disagreement over the complex issue of restrictions as exemplified by the *Goetz* decision. Hence, the court found that the defendant did not make a false statement prior to *Goetz*. The court also noted that because of the unsettled nature of the law, it would be unfair to subject the defendant to punitive damages under the FCA. Furthermore, the court held that the FCA is not a "catch-all" enforcement vehicle for all regulations, and that statutory remedies may be the appropriate vehicle for policing compliance. Accordingly, the court granted the defendant's summary judgment motion regarding restrictions claimed prior to *Goetz*.

Obligation Element

The court's decision on obligation was limited to the question of what obligation the defendant owed to the federal government under FCA section 3729(a)(7). After consideration of different analyses of "obligation" by various courts, the court found that the defendant company did not owe an obligation to pay the government under FCA section 3729(a)(7) for the alleged false claims to state Medicaid. The court found that the defendant did not have an existing obligation to pay the government at the time the allegedly false statements were made and that the defendant company did not have a specific economic relationship with the government, independent of any relationship with the state Medicaid agency. This holding was supported by the fact the defendant was not a health insurer. The court granted summary judgment in favor of the defendant company with regard to the element of obligation.

Collateral Estoppel

The court found that the defendant company was not collaterally estopped from arguing that applying any plan restrictions, whether procedural or substantive, did not subject the defendant company to FCA liability. The government argued that the Sixth Circuit in *Caremark v. Goetz*, 480 F.3d 779 (6th Cir. 2008), "conclusively determined" that the defendant's obligation to pay Medicaid requests for reimbursement could not be avoided through applying procedural plan restrictions and that the defendant was estopped from re-litigating the same point. The court found that collateral estoppel did not apply with FCA claims because the FCA was not at issue before the court in *Goetz*. Accordingly, the court denied summary judgment for the government as to the collateral estoppel claim.

Statute of Limitations

The court found that the government's FCA claims prior to August 19, 1999 (the date on which the complaint-in-intervention was filed) were time barred. The defendant had argued that the filing of a *qui tam* action by a relator did not

give notice to the party being sued because it was filed under seal. In contrast, the government argued that the FCA claims that arose before August 19, 1999 were not time barred because: (1) the complaint-in-intervention related back to the relator's *qui tam* complaint under Fed.R.Civ.P. 15(c)(1); (2) relation back was also possible under Fed.R.Civ.P. 15(c)(2) because the defendant company had adequate notice of the government's claims; and (3) the statute of limitations was tolled when the relator filed her original complaint. The government also asserted that the statutory scheme of the FCA allowed the government to apply for extensions beyond the initial sixty days to conduct its investigation per FCA section 3730(b)(3). While the court acknowledged there was case law supporting both of the parties' positions, the court found that adopting the government's argument would belie the intent of the FCA statute of limitations provision and would also contradict the well-settled notice requirements within the Fed.R.Civ.P. The court found that the government's FCA claims prior to August 19, 1999 were time barred, and that the critical date for statute of limitations purposes was the date that the government filed its complaint-in-intervention. The court found that the statute of limitations period prevented the government from pursuing claims that occurred prior to six years before it filed the complaint-in-intervention. The court also found that the government's complaint-in-intervention did not relate back under Fed.R.Civ.P. 15 (c)(1) or 15 (c)(2) because the defendant company did not receive notice until the complaint-in-intervention was filed on August 19, 2005. The court granted summary judgment in favor of the defendant company on the statute of limitations issue.

U.S. v. Bourseau, 2008 WL 2718878 (9th Cir. July 14, 2008)

The Ninth Circuit affirmed the U.S. District Court for the Southern District of California's ruling that a group of defendants violated the False Claims Act by improperly billing Medicare. The defendants owned and controlled a parent company that owned and operated a psychiatric hospital that participated in the Medicare program. Following a bench trial, the district court found that, after the parent company filed a bankruptcy petition, it improperly included on its Medicare costs reports expenses for bankruptcy legal fees that exceeded the amount of fees related to the psychiatric hospital; nonallowable interest that was never paid, was owed to a related party, and/or did not relate to patients at the psychiatric hospital; expenses related to the procuring additional space that was not used for patient services; expenses for management services that were never provided; and rental expenses that never existed. The district court held the defendants jointly and severally liable for reverse false claims, and assessed treble damages and civil penalties totaling more than $15 million. Each of the defendants appealed, and the Ninth Circuit affirmed.

Reverse False Claims

The Ninth Circuit held that, for a variety of reasons, the Medicare cost reports that the defendants submitted to their Medicare intermediary contained nonallowed costs. As a result, the court held that the cost reports were false and constituted the basis of a reverse false claims violation. The circuit court further determined that the defendants had knowledge—at the very least, they acted with reckless disregard or deliberate ignorance of the truth—that the cost reports were false, since the false claims largely arose from alleged payments that were never made, from alleged services that were never performed, or from alleged expenses that were unrelated to any patient services rendered by the psychiatric hospital. One of the defendants sought to escape liability by arguing that there was no reverse false claims violation because he did not 'make, use, or cause to be made or used a false statement.' The court rejected that argument—which it said was tantamount to an argument that the defendant did not present a false claim to the intermediary nor cause a false statement to be presented to the intermediary. The court determined that such presentment arguments were limited to section 3729(a)(1) of the False Claims Act, and had no applicability to section (a)(7). The court also rejected the defendants' argument that there was no reverse false claims violation because they had no pre-existing obligation to pay Medicare a fixed amount, because the cost reports were never audited. The court, having adopted the rationale followed by the Sixth and Eighth Circuits in determining whether an obligation exists under section 3729(a)(7) of the False Claims Act, found that the Medicare regulations imposed on the defendants "a continuing, specific obligation to repay" any overpayments at the end of each reporting period. Thus, the court held, the defendants had a legal obligation to repay the government at the time it submitted its cost reports, even though the specific amount of the repayment may not have been known at that time, and even if the defendants planned to challenge whether some of the expenses should have been allowed. The court agreed that the False Claims Act contains an implicit materiality requirement, but held that, under the "natural tendency test," the defendants' cost reports were material, since the reports had the potential effect to decrease the amount that the defendants were to repay to Medicare.

Damages

The defendants argued that, notwithstanding the district court's finding of liability, the government did not sustain any damages because, as a result of the bankruptcy proceeding, Medicare never relied on the false cost reports for adjusting payment rates. The court rejected this theory, noting that by including nonallowable costs in their cost reports, the defendants impeded the intermediary's ability to determine whether the a rate adjustment was necessary, which, in turn, prevented Medicare from making payments are proper, lower rates. The

court further noted that the district court properly calculated the amount of damages to be paid by the defendants, stating that "[d]amages for a reverse false claim consist of the difference between what the defendant should have paid the government and what the defendant actually paid the government." Since the defendants did not cooperate with the government, they were not eligible for the a reduction to double damages. Therefore, once the district court determined the amount of damages, it properly trebled that amount—and that decision was not unconstitutional, since the evidence showed that the damages were not grossly disproportional to the gravity of the defendants' offense.

See *U.S. ex rel. Mason v. State Farm Mut. Auto. Ins. Co.*, 2008 WL 2857372 (D. Idaho July 23, 2008), at page 55.

FALSE CLAIMS ACT RETALIATION CLAIMS

Dilback v. General Elec. Co., 2008 WL 4372901 (W.D. Ky. Sep. 22, 2008)

The plaintiff brought a *qui tam* action against his former employer, an aircraft manufacturing company. The parties settled all of the claims except for plaintiff's retaliation claim. Plaintiff then requested discovery regarding, in part, information about whether or not the underlying fraud actually occurred. The defendant refused to produce this discovery. The plaintiff then brought a motion to compel which the Magistrate Judge denied. After reviewing the order, the United States District Court for the Western District of Kentucky found that the information was relevant to the plaintiff's FCA retaliation claim. Specifically, it held that a retaliation claimant does not need to prove actual fraud to prevail. Instead, it found that a plaintiff need only show engagement in activity related to viable FCA claim. Accordingly, since the defendant acknowledged that the plaintiff investigated and filed a viable *qui tam* claim, evidence relating to the alleged underlying fraud was not relevant and not discoverable. However, the court found that proof of the alleged fraud was relevant because it could be used to prove the defendant's motivation to retaliate. The court accepted the plaintiff's argument that because the defendant asserted a non-retaliatory reason as to why the plaintiff was terminated, he should be permitted to use evidence of fraud to prove that the stated reason was merely pretext. The court then allowed limited discovery into the underlying fraud.

Kuhn v. LaPorte County Comprehensive Mental Health Council, 2008 WL 4099883 (N.D. Ind. Sep. 04, 2008)

The plaintiffs filed a complaint in the United States District Court for the Northern District of Indiana alleging that the defendant, a non-profit mental health center, illegally terminated the plaintiffs from their employment. The plaintiffs alleged that they were "whistleblowers" impermissibly terminated for engaging in statutorily protected activity. The defendant contended that the plaintiffs were terminated for other permissible reasons and moved for summary judgment. The court observed that to prove retaliation under FCA section 3730(h), a plaintiff must show: (1) that the plaintiff's actions were taken "in furtherance of" an FCA enforcement action and were therefore protected by statute; (2) that the defendant knew that the plaintiff was engaged in such protected activity; and (3) that the plaintiff's discharge was motivated by the protected activity. The court denied the motion for summary judgment.

The defendant argued that the plaintiffs' actions were not protected under the FCA because the plaintiffs violated federal and state privacy laws by disclosing confidential patient records to an outside attorney as part of their investigation. The defendant further argued that the plaintiffs' conduct was unprotected under the FCA because the altered documents were never presented to the government for payment. The court rejected both of these arguments and held that the plaintiffs' actions were statutorily protected activity. First, the court found that disclosure of investigative records to outside counsel was lawful under 45 C.F.R. § 164.502(j). Second, the court observed that the plaintiffs were not required to show that the defendant was subsequently liable for its actions in order to have been engaged in protected activity. Instead, the plaintiffs needed only to submit substantial evidence establishing that their "investigatory conduct" was motivated by good faith. They did so by showing that there was a history of problems with Medicaid billing, that an internal audit occurred, that documents were altered by the defendant's employees, and that the plaintiffs took steps to protect the defendant from legal liability.

The court also held that the plaintiffs sufficiently notified the defendant of their qui tam action. The court recognized that different employees have differing notice obligations under the FCA and that employees who are normally engaged in reporting fraudulent activity are under a heightened obligated to indicate an explicit intention to bring a *qui tam* action or to otherwise report the fraud, while other employees need only show that the employer was aware of the fraud investigation. The court held that even the heightened obligation was satisfied, since the plaintiffs communicated their intent to report the suspected fraud to the defendant's HR director. Furthermore, the plaintiffs submitted depositions of the defendant's employees to the defendant's board president.

Finally, the court rejected the defendant's argument that the plaintiffs were terminated for reasons other than their FCA concerns. The court found that the timing of the plaintiffs' firings created a material issue of fact. One plaintiff was fired only three days after she notified the defendant of her investigation and only a week after she received a substantial pay raise. The other plaintiff was dismissed the day after he stated his intent to report the alleged fraud.

COMMON DEFENSES TO FCA ALLEGATIONS

A. Lack of Materiality

U.S. ex rel. Romano v. New York-Presbyterian Hospital, 2008 WL 2775703 (S.D.N.Y. July 16, 2008)

Relator filed an action in the United States District Court for the Southern District of New York against New York Presbyterian Hospital, alleging that the hospital violated section 3729(a)(2) of the False Claims Act by assisting and causing Columbia University to create and use false patient charts and records in order to get false Medicaid claims paid. The hospital filed its first motion for summary judgment, arguing that the submission of the Medicaid claims at issue could not satisfy the statute's "presentment" requirement, since those Medicaid claims were not presented to a federal agency, but rather to the state's Medicaid office. The court denied that motion, at *U.S. ex rel. Romano v. New York-Presbyterian Hosp.,* 2008 WL 904730 (S.D.N.Y. Apr. 2, 2008), holding that section 3729(a)(2) does not include a presentment requirement. The hospital renewed its summary judgment motion, following the Supreme Court's recent ruling in the *Allison Engine Co., Inc. v. United States ex rel. Sanders* case. The hospital alleged that section 3729(a)(2) only imposes liability on one who "knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government," and that its Medicaid claims were not paid or approved by the federal government, but by the state Medicaid agency. Moreover, the hospital argued that the Supreme Court, in *Allison Engine,* held that, in order to maintain a claim under section 3729(a)(2), a relator would have to show that the defendant intended the false statement to be used and be material to the government's decision to pay or approve the false claim. The court, however, again denied the hospital's motion, first holding that under section 3729(a)(2), claims need not be submitted directly to the federal government but can be submitted to a third party. The court then held that that the relator's complaint conformed to the standards outlined in *Allison Engine,* since the complaint showed that the even though the hospital's Medicaid claims were submitted to the state agency, which then sought payment from the federal government, the hospital's alleged false statements were ultimately made with the intent that they would be material to the federal government's decision to pay or approve those claims.

B. Not A Condition of Payment

See *Abner v. Jewish Hosp. Healthcare Services, Inc.*, 2008 WL 3853361 (S.D. Ind. Aug. 13, 2008), at page 42.

C. *Res Judicata*/Collateral Estoppel

U.S. ex rel. Lusby v. Rolls-Royce Corp. 2008 WL 4247689 (S.D. Ind. Sep. 10, 2008)

The plaintiff, a former employee of the defendant, filed a *qui tam* action alleging that the defendant knowingly manufactured and sold defective aircraft parts to the government. The plaintiff had previously filed a complaint against the same company alleging age discrimination and unlawful retaliation in violation of the FCA. That earlier complaint was dismissed with prejudice by stipulation. In his subsequent FCA complaint (the complaint at issue), the plaintiff alleged that the defendant violated the FCA by: 1) presenting false documents to the government, certifying that the delivered aircraft parts conformed to contract specifications; and 2) inducing the government to settle the dispute over the faulty aircraft parts for a lower amount by making false statements to the government regarding its quality control procedures. The government declined to intervene. Upon motion, the United States District Court for the Southern District of Indiana then dismissed the second complaint for failing to plead claims with sufficient particularity but granted leave to the plaintiff to file an amended complaint. However, the plaintiff missed the deadline to file his amended complaint and then filed a motion for leave to file the amended complaint. The defendant opposed this motion, arguing that the proposed amended complaint was barred by *res judicata*, and that the plaintiff failed to plead his FCA claims with particularity as required by Fed.R.Civ.P. 9(b). The court denied the plaintiff's motion for leave to file an amended complaint and dismissed his suit.

Res Judicata

The court held that *res judicata* principles applied to FCA claims and compared the proposed amended complaint with the plaintiff's previous suit. The court found that the parties in both cases were identical, there was an identity of causes of action since both suits arose from the same allegations, and there was a final judgment on the merits in the first case, since a dismissal by stipulation is a final judgment with preclusive effect of barring claims that could have been raised in a prior suit. Accordingly, the court held that the proposed amended complaint was barred by the doctrine of *res judicata*.

Particularity Requirements Under Fed.R.Civ.P. 9(b)

The plaintiff argued that he had satisfied the heightened pleadings requirements for his allegations regarding FCA sections 3729(a) (1) & (2) by alleging the relevant contracts, the applicable regulations, the dates of shipments, and the payments made by the government. However, the court observed that he had neither identified the date nor the contents of a single claim. Instead, the court found that the plaintiff alleged an inference of fraud which can not satisfy the heightened fraud pleading requirements under Fed.R.Civ.P. 9(b). Similarly, the plaintiff's claim under section 3729(a)(7) did not identify the content or speaker of any false statement by the defendant company that induced the government to settle the contract dispute. Therefore, the court held that the proposed amended complaint did not plead its claims with particularity.

Reverse False Claims Allegation

The court also found that plaintiff's complaint failed to allege that the defendant company had an obligation to pay money to the government because the defendant did not have a pre-existing legal duty to pay the government. It held that defending a claim for payment by the government does not create an obligation under the FCA. Otherwise, it held that such an expansive reading of the term "obligation" would result in a flood of litigation. Accordingly, the court denied the motion for leave to file an amended complaint and dismissed the case with prejudice.

U.S. v. Khan, 2008 WL 2782669 (E.D. Mich. July 16, 2008)

Defendant was a member of a group that was indicted on various charges involving a scheme to defraud the Government. The Government commenced a civil action against the defendant, alleging, among other things, claims that the defendant was liable for four years of filing false claims, in violation of the FCA. Once the defendant pled guilty to one count of health care fraud in the criminal case, the Government moved for partial summary judgment on the issues of liability and civil penalties under the False Claims Act. Although the defendant had pled guilty in the criminal case, he asserted that he was only liable for one year of filing false claims, not for years, as the Government contended. The court found that the defendant was estopped, by virtue of his guilty plea, from denying liability for all four years. The court also found the defendant liable for treble damages, and required him to pay a penalty for each claim filed. The Government's motion for partial summary judgment was granted.

The Government commenced a civil action against Amjad Khan, for his alleged involvement in a scheme to defraud the Government from 1996 to 1999. Khan was also criminally indicted and eventually pled guilty to one count of health

care fraud. Following Khan guilty plea, the Government sought partial summary judgment on its civil claims under FCA subsections 3730(a) and (b) for presentment of false claims and false statements. Khan opposed the government's motion, arguing that his liability should be limited only to the year 1997. The Government argued that Khan should be estopped from denying liability by virtue of his guilty plea.

The U.S. District Court for the Eastern District of Michigan held that Khan was estopped from contesting liability for any of the four years, due to his guilty plea, and granted the Government's motion for partial summary judgment. The court held that a guilty plea in a criminal matter has a preclusive effect on similar, future proceedings, according to the doctrine of collateral estoppel. The court found that Khan's guilty plea estopped him from contesting his liability, since, in his plea, Khan agreed that the relevant conduct of the case included the years 1996-1999, and he agreed to pay restitution for Government losses sustained for all four years. Accordingly, the Government's motion for partial summary judgment was granted. The court also required Khan to pay three times the amount of restitution ordered by the court (totaling $3,203,097). Finally, the court imposed a penalty of $5000 for each false claim filed.

See *U.S. ex rel. Ramadoss v. Caremark Inc.*, 2008 WL 3978086 (W.D.Tex. Aug. 27, 2008), at page 23.

D. Sovereign Immunity

Kendall v. Chief Leschi School, Inc., 2008 WL 4104021 (W.D. Wash. Sep. 03, 2008)

The plaintiff brought a *qui tam* action against the defendants, a school and an Indian tribe, seeking relief under the Federal Whistle Blower Protection Act, 31 U.S.C. §1730, and the FCA. The government declined to intervene in the action. The plaintiff alleged that the defendant school fired her in retaliation for investigating fraud against the government. The defendants filed a motion to dismiss for lack of subject matter jurisdiction based on the tribe's sovereign immunity. In response, the plaintiff sought a stay for the purpose of conducting discovery into an alleged waiver of sovereign immunity. The United States District Court for the Western District of Washington granted the motion to dismiss. The court held that the FCA does not waive sovereign immunity. Hence the tribe and its school, acting as an "arm of the tribe," were immune from FCA claims as long they did not consent to a waiver. The court then found that the there was nothing in the pleadings indicating such a waiver. Accordingly, the court determined that it lacked subject matter jurisdiction over the defendants and dismissed the case.

E. Statute of Limitations

U.S. ex rel. Herndon v. Appalachian Regional Community Head Start Inc., 2008 WL 2873363 (W.D.Va. July 25, 2008)

Relator, G. Wayne Herndon, originally filed a claim for retaliation under the FCA, against his former employer, Appalachian Regional Community Head Start Inc. Herndon alleged that Appalachian wrongfully terminated his employment after he reported their "wrongdoing" and "misappropriation of funds." Subsequently, Herndon voluntarily dismissed his lawsuit. Thereafter, he brought the present suit against Appalachian, in which he alleged similar claims. Appalachian moved for summary judgment, and argued that Herndon's retaliation claim was barred by the applicable statute of limitations. In deciding this issue, the United States District Court for the Western District of Virginia was required to apply the statute of limitations period found in the state statute that is most analogous to the FCA's retaliation provision. The court decided that the applicable limitations period was two years, as prescribed by Virginia statute. Although Herndon's suit was filed more than two years after he was discharged, the court applied Virginia's tolling statute, which provides that a party who voluntarily dismisses a cause of action may recommence it, in state or federal court, within six months. Herndon had re-filed his case within six months, which tolled the period of limitations. Therefore, the court found Appalachian's statute of limitations defense to be without merit, and denied Appalachian's motion for summary judgment.

See *U.S. ex rel. Foster v. Bristol-Myers Squibb Co.*, 2008 WL 4360697 (E.D. Tex. Sep. 24, 2008), at page 37.

See *U.S. ex rel Gonzalez v. Fresenius Medical Care North America*, 2008 WL 4277150 (W.D. Tex. Sep. 02, 2008), at page 41.

See *U.S., ex rel. Ramadoss v. Caremark Inc.*, 2008 WL 3978086 (W.D.Tex. Aug. 27, 2008), at page 23.

See *U.S. ex rel. Serrano v. Oaks Diagnostics, Inc.*, 2008 WL 2930348 (C.D.Cal. July 25, 2008), at page 44.

FEDERAL RULES OF CIVIL PROCEDURE

A. Rule 9(b) Failure to Plead Fraud with Particularity

U.S. ex rel. Foster v. Bristol-Myers Squibb Co., 2008 WL 4360697 (E.D. Tex. Sep. 24, 2008)

The relator brought a *qui tam* action against a pharmaceutical company, alleging that the defendant illegally bribed and gave kickbacks to a HMO in order to induce doctors to prescribe the defendant's drugs. The relator also alleged that the defendant reported inflated prices for those drugs to avoid paying Medicaid rebates to the government and overcharged federally-qualified entities for drugs under the Public Health Service Act. The government declined to intervene. The defendant moved to dismiss on the following grounds: (1) that the claims were barred by the statute of limitations; (2) that the claims were not plead with particularity under Fed.R.Civ.P. 9(b); (3) that the relator failed to state an actionable claim under the FCA; and (4) that the relator failed to comply with statutory service and filing requirements. The United States District Court for the Eastern District of Texas held that the relator was subject to a six year statute of limitations and that all federal and state FCA violations based on false claims submitted before March 31, 1999 were barred. The court also held that the relator did not satisfy the pleading requirements under Fed.R.Civ.P. 9(b) because he failed to plead sufficient facts in support of his allegations. The court thus dismissed all federal and state FCA claims and granted in part the defendant's motion to dismiss. The court declined to exercise supplement jurisdiction over the relator's remaining claims brought under the California FCA.

The relator previously worked as National Account Manager for one of the defendant's competitors. He claimed that both his company and the defendant used financial rewards to fight to be included on an HMO's formulary (a list of medications for which an HMO provides coverage). After a competitive bidding war, the defendant's similar drug Pravachol was included in the formulary as the defendant's incentives were allegedly better. The relator alleged that he subsequently learned the defendant did not include their incentives in the "best price" amount it reported to Medicaid for Pravachol and another drug called Glucophage and that this omission resulted in lowering or eliminating the defendant's obligation to pay Medicaid rebates and allowed the defendant to offer greater incentives for including its drugs in a formulary. The relator alleged that this scheme violated the FCA by underreporting the amount of Medicaid rebates due to the government. Furthermore, under an apparent implied cer-

tification theory, the relator alleged that claims for reimbursement for drugs prescribed because of the unlawful kickbacks would not have been paid by the government. Finally he alleged that by underreporting the amount of Medicaid rebates owed, the defendant also caused entities covered by the Section 340B program of the Public Health Service act to overpay for prescriptions, which constituted a false claim.

Statute of Limitations

The relator argued that he should have the benefit of the ten year limitations period applicable to the government under § 3731(b)(2). The court, however, held that relators are distinct entities from the government under the FCA, and that actions brought by a relator are governed by the six year limitations period under § 3731(b)(1). Accordingly, the court held that a portion of the relator's FCA claims were barred by the statute of limitations.

Particularity Requirement

The court found that the relator's complaint was deficient as he failed to plead sufficient facts in support of his allegations under Fed.R.Civ.P. 9(b). The court first addressed whether or not the relator was entitled to a relaxed pleading standard because (1) the information of the alleged fraud was in the defendant's possession; or (2) the alleged fraud was part of a complex scheme that occurred in a multi-year period. The court found that the first exception did not apply because the information the relator alleged he did not have was not solely in the possession of the defendant, since the government and healthcare providers also held information necessary to realtor's claims. However, the court relaxed the pleading requirements because the fraud alleged by the relator consisted of a scheme that occurred over the course of several years and involved numerous acts.

The court then addressed whether the relator's complaint satisfied even the relaxed pleading requirements. With respect to the kickback allegations, the court observed that the relator did not list a single instance in which a doctor selected the defendant's drug over that of the competitor because of a kickback. Nor did he allege how any such prescription was connected to Medicaid or how a false claim was presented to the government. Accordingly, even under the relaxed pleading standard, the court found that the relator's allegations were not pled properly. Likewise, the court found that the relator failed to allege any facts that would support his claims that the defendant underreported the amount of Medicaid rebates due to the government and overcharged Section 340(b) entities. As a result, the court granted the defendant's motion to dismiss. The court then declined to exercise supplemental jurisdiction over the remaining claim under the California FCA, denied relator's request to amend his complaint, and dismissed the suit with prejudice.

U.S. ex rel. Rost v. Pfizer, Inc., 2008 WL 4293642 (D. Mass. Sep. 18, 2008)

The relator, a former vice president of one of the defendant pharmaceutical companies, filed a *qui tam* action alleging that the defendants unlawfully promoted the non-FDA approved, off-label use of a growth hormone medication. The relator alleged that once the defendants began marketing the drug for off-label uses, sales of the drug dramatically increased. He alleged that since Medicare did not authorize reimbursement for the non-FDA approved usages, Medicare claims for reimbursement associated with the off-label use of the drug were violated the FCA. The relator further alleged that the reimbursement claims for the drug were the result of unlawful kickbacks. The government declined to intervene. The initial complaint was dismissed for failure to meet the particularity requirement of Fed.R.Civ.P. Rule 9(b). The relator then filed an amended complaint and the defendants again moved to dismiss. The United States District Court for the District of Massachusetts denied the motion in part, holding that the amended complaint was properly pled and that the relator's allegation of unlawful kickbacks necessitated discovery. The court, however, dismissed the allegations relating to off-label uses.

Particularity Requirement

The court held that the amended complaint satisfied Fed.R.Civ.P. Rule 9(b)'s heightened pleading requirement, as it observed that the relator's amended complaint detailed more than 200 false claims submitted to Medicare and other federal programs from citizens of Indiana. The relator described in detail the drug for which reimbursement was sought, the medical diagnosis accompanying the claim, the diagnosis and dispensation dates, and the dosage. The court held that such a detailed description fulfilled the heightened pleading requirement.

Falsity of Claims

The defendants argued that the alleged claims were not false because the State of Indiana had approved the off-label usages of the drug. While the court seemingly agreed with this point, it held that the relator's additional allegations of unlawful kickbacks were sufficient to properly plead his claim under the FCA. The court observed that the relator had generally alleged that the defendants engaged in a marketing campaign that had caused the submission of false claims by doctors. While the relator would be required to specifically demonstrate this allegation to ultimately prevail, the court found that the relator was unable to allege this information in the complaint as it was not in his possession. Accordingly, the court permitted limited discovery relating to the sales and marketing region of defendants that included Indiana.

Hopper v. Solvay Pharmaceuticals, Inc., 2008 WL 4177927 (M.D. Fla. Sep. 08, 2008)

The relators brought a *qui tam* action alleging that the defendant pharmaceutical company illegally marketed Marinol, a prescription drug that is a derivative of marijuana, for uses not approved by the U.S. Food and Drug Administration. The government declined to intervene in the case. After the lawsuit was unsealed, the relators filed a second amended complaint that alleged that the defendant's marketing campaign caused physicians to prescribe Marinol for off-label uses. As a result, false claims for Marinol prescription reimbursement were allegedly submitted to government healthcare programs. The defendants moved to dismiss under Fed. R. Civ. P 9(b) and lack of subject matter jurisdiction. The United States District Court for the Middle District of Florida referred the motion to dismiss to a magistrate judge and adopted the magistrate's recommendations to deny the motion to dismiss on the basis of subject matter jurisdiction and to grant the motion to dismiss for failing to plead with particularity.

Particularity Requirement

The court held that the relators failed to state with particularity their claim that the defendants' illegal marketing scheme caused the submission of false or fraudulent claims to the government. The defendant argued that the relators failed to plead a specific allegation of an actual false claim that was submitted to the government. The relators conceded that they had no evidence of a false claim but argued that an inference could be made from the allegations that a false claim was submitted to the government. The court concluded that the Eleventh Circuit dictated that FCA claims must specifically allege that a false claim was actually submitted to the government. Furthermore, a court cannot infer that false claims were submitted to the government even with detailed allegations of an underlying fraudulent scheme. Therefore, the court held that the relators failed to state their claim with particularity.

Lack of Subject Matter Jurisdiction

The defendant contended that the FCA barred jurisdiction over the second amended complaint because it contained allegations from publicly disclosed documents and that the relators were not the original source of the information in the complaint. The court held that by specifically pleading that their information was not based on a public disclosure and that they were an original source of the facts was sufficient to establish jurisdiction over the relators' claims. Hence, the court denied the defendant's motion to dismiss to the extent that it challenged subject matter jurisdiction.

U.S. ex rel Gonzalez v. Fresenius Medical Care North America, 2008 WL 4277150 (W.D. Tex. Sep. 02, 2008)

The plaintiff brought *qui tam* and retaliatory discharge actions against a medical facility and its director before the United States District Court for the Western District of Texas. The relator alleged that the defendants falsified medical records and submitted false claims for dialysis services to Medicare in violation of the FCA. In particular, she alleged that the defendants billed for medical services provided by two persons who were not licensed to provide those services and that the defendants instructed their employees to conceal and alter medical records to avoid detection by Medicare officials. She further alleged that after learning of her whistle-blowing activities, the defendants forced her to tender her resignation. The defendants filed motions to dismiss arguing: (1) the plaintiff failed to satisfy the heightened pleading standards under Fed.R.Civ.P. 9(b); (2) the plaintiff failed to state a claim for conspiracy in violation of the FCA; and (3) the application of the statute of limitations barred part of the relator's claims. The court held that the plaintiff pled sufficient details in her complaint to defeat the motions to dismiss and that the statute of limitations did not bar any of her claims. However, the court dismissed her retaliation claim because the defendant manager was not covered within the definition of "employer."

Particularity Requirement

The defendants argued that the plaintiff failed to plead three of her fraud claims without particularity under Fed.R.Civ.P. 9(b). Each is discussed below.

Factually False Medicare Submissions: The plaintiff's first fraud claim alleged the submission of factually false Medicare claims. The defendants argued that the complaint failed to allege fraud because it did not allege that the defendants incorrectly described the services billed to Medicare or that the services submitted for reimbursement were never provided. The court rejected this argument and observed that the plaintiff's complaint provided specific details regarding the creation and submission of false bills and reports, details about the alleged unauthorized treatment of patients by the two allegedly unauthorized persons, and the defendant's knowledge of the same. The plaintiff also pled examples of the same in regards to specific patients. The court held that since the defendants were responsible for ensuring that their billing complied with Medicare regulations, the plaintiff's allegations were sufficient to state a claim under the FCA.

Legally False Medicare Submissions: The plaintiff also alleged that the defendants improperly billed for the services provided by the allegedly unlicensed persons in violation of Medicare regulations. The defendants argued that the applicable regulations did not require compliance as a condition of payment. The court concluded that the plaintiff properly pled a false certification claim,

finding that 42 C.F.R. § 424.520(a)(2) mandated that compliance with applicable regulations was a condition for payment as a Medicare provider or supplier.

Conspiracy Claim: Finally, the plaintiff alleged that the defendants conspired to defraud Medicare into paying false or fraudulent claims. The defendants argued that the plaintiff's conspiracy allegation was conclusory and failed to allege an agreement to defraud. The court observed that the plaintiff alleged that the medical facility knew that the director was concealing unlawful activities. Furthermore, she alleged that the facility knowingly allowed the unlicensed persons to treat patients while having their medical records falsified to indicate they were dictated by a medical director. The court held that these allegations were sufficient to plead conspiracy and denied the motion to dismiss in regards to pleading with particularity.

Statute of Limitations

The defendants argued that the limitations period of six years, pursuant to FCA section 3731(b)(1), should apply. The court disagreed and concluded that FCA section 3731(b)(2) was the applicable statute. Relying on *United States ex rel. Pogue v. Diabetes Treatment Ctrs. of Am.*, the court held that relators are included under subsection (b)(2)'s tolling provision.

Abner v. Jewish Hosp. Healthcare Services, Inc., 2008 WL 3853361 (S.D. Ind. Aug. 13, 2008)

In the United States District Court for the District of Indiana, two former employees of the two defendant healthcare providers alleged that a group of defendants committed fraud and unlawful retaliation in violation of the FCA. The relators alleged that defendants issued policy statements and instructed laboratory employees to generate fraudulent Medicare and Medicaid bills under six separate claims, and falsely certified compliance with Medicare regulations in their billing practices. The defendants moved to dismiss all of the relators' claims for failure to state a claim for relief. After describing the standards for pleading under Section 3729(a)(1) and (2), the court found that the relators' allegations on the first three allegedly fraudulent billing practices were pled with sufficient particularity because they either alleged specific transactions or they included claims regarding how the defendants allegedly defrauded the government. The court, however, dismissed two other claims—regarding the defendants' alleged ineffective testing—for failing to state a claim, noting that the relators failed to allege a specific regulation that would indicate falsity. The court noted that claims under a false certification theory must "point to a specific regulation conditioning payment of a claim on a certification of compliance." Finally, the court denied the defendants' motion with respect to the relators' retaliation claims, since the relators were fired immediately after the defendants

learned of their intention to reveal the defendants' allegedly fraudulent conduct—the court held that this evidence was sufficient to support the relators' contention of an unlawful motivation.

Pleading Fraud With Particularity

The defendants argued that the relators' allegations of false billing were not pled with particularity because the relators failed to allege that the claims were actually submitted for payment, failed to submit proof that the claims were actually false, and failed to allege that the defendants knew the claims were false. The court, because of inexact pleading by the plaintiffs, analyzed the motions under both sections 3729(a)(1) and (2). The principal difference between the two sections is that subsection (a)(1) requires the relators to allege submission of a claim for payment under adequate indicia of reliability while subsection (a)(2) does not. Further, the court noted that while pleadings need not prove claims, they must describe how the relator knows or has reason to know of his/her allegations. Consequently, the court found that the relators' allegations of specific patients for whom defendants improperly billed the government, as well as the relators' positions as employees of the defendants, were adequate to survive a motion to dismiss. However, the court did dismiss those claims that were not pled with facts describing individual transactions or which failed to describe how the defendants accomplished the alleged fraud. The court also rejected the notion that a relator must "prove" a claim of falsity by evidence, noting that a specific allegation of falsity will do. Next, the court held that while fraud must be pled with particularity, intent need not be so pled. Thus, an allegation that a corporate defendant participated in a scheme of fraud through an agent is sufficient to plead that the defendant had knowledge of the fraud.

False Certification Theory

The court observed that several circuits have interpreted the FCA to apply to a party who falsely certifies compliance with a federal regulation. The court held that, in order to properly plead this theory, a relator must point to a specific regulation conditioning payment of a claim on a certification of compliance. The relators premised each of their claims of fraudulent billing on a false certification theory but failed to point to any specific regulation. As a result, the court dismissed their false certification claims. The court declined to address the implied false certification theory, noting that neither party had briefed the issue, but the court allowed the relators to amend their pleadings in order to discuss the issue.

Retaliation Claims

The relators claimed that the defendants fired them for expressing their concerns and their intent to notify authorities of the defendants' alleged fraudulent billing practices. The court held that the relators' allegation that the defendants

fired them immediately after learning of their intentions to reveal fraudulent conduct sufficed to plead unlawful motivation. Thus the court denied the defendants' motion to dismiss the relators' retaliation claims.

U.S. ex rel. Staniszewski v. Washington & Jefferson College, 2008 WL 2987213 (W.D. Pa. July 31, 2008)

In his *qui tam* action, relator Matthew Staniszewski alleged that Washington & Jefferson College violated the FCA, by providing false statements, records, and claims in order to receive payment from the government. The college acted as a sub-contractor to provide a degree program and related seminars to National Guard members. This project was federally funded. During the course of the project, the college purchased various products (computers, digital cameras, etc.) for the benefit of the National Guard program, which Staniszewski argued were not used for the National Guard project, but instead were used by the college's traditional students. Staniszewski also alleged that the college submitted improper bills to the government for labor charges related to the National Guard program. The college moved to dismiss the complaint, arguing that the relator's second amended complaint failed to meet the particularity requirements of Fed.R.Civ.P. 9(b), and that motion was heard by a magistrate judge, who determined that the complaint failed to satisfy Rule 9(b)'s particularity requirements. The United States District Court for the Western District of Pennsylvania adopted the magistrate judge's recommendation. The court determined that Staniszewski failed to explain how he came to learn of the college's alleged false claims, and that he also failed to demonstrate that the college's claims were fraudulent, or even actually made. The court found that Staniszewski's pleadings failed to make any factual averments which would support his claims of fraudulent and false statements. While the court did determine that the he leveled sufficient charges against the college to provide notice in relation to the alleged fraudulent conduct, the court found that he failed to allege facts that substantiated his claims. The court also found that Staniszewski failed to identify any sort of relationship with the college. Accordingly, the court adopted the magistrate judge's report and recommendation, and granted college's motion to dismiss, with prejudice.

U.S. ex rel. Serrano v. Oaks Diagnostics, Inc., 2008 WL 2930348 (C.D.Cal. July 25, 2008)

Relator originally brought a *qui tam* action against a diagnostic center, its owner and other employees, alleging that the defendants violated FCA sections 3729(a)(1), (a)(2), and (a)(3). The government intervened five years after the original complaint was filed, and filed a complaint in intervention. The defendants moved to dismiss the entire action with prejudice, and

claimed that the government failed to state a proper claim for relief under Fed.R.Civ.P. 12(b). They also argued that the government pled claims outside the applicable statute of limitations, and failed to plead fraud claims with sufficient particularity under Fed.R.Civ.P. 9(b). The United States District Court for the Central District of California denied the defendants' motion to dismiss in part, and granted the motion in part. The court found that the relator's original complaint was filed within three years of the alleged conduct, and therefore the defendants' motion to dismiss with respect to the applicable statute of limitations was denied. The court found that the government's complaint failed to properly state a fraud claim, since it did not specify the allegedly false claims with the particularity required to satisfy the heightened pleading standard of Fed.R.Civ.P. 9(b). Accordingly, the government's claims fraud and FCA claims were dismissed. However, the government was granted a 30-day leave to amend the entire complaint.

The government contended that the defendants, Oaks Diagnostics, its owner Dr. Ronald Grusd, and Dr. Earl Fernando and other unspecified employees, violated the FCA when they engaged in a scheme to defraud the government by performing unnecessary diagnostic testing and billing Medicare for it. In addition to FCA claims, the complaint alleged causes of action for common law fraud, conversion, payment by mistake, negligent misrepresentation, and money had and received. One of Oaks' employees had previously been criminally convicted for participation in a fraudulent billing scheme, and the complaint alleged that the defendants were aware of this fraudulent activity, or (at a minimum) were deliberately ignorant of the activities. The defendants moved to dismiss the complaint for failure to meet the statute of limitations and for failure to plead fraud with specificity. The court granted the motion in part, and denied it in part. The court denied the defendants' motion with respect to the statute of limitations, and held that the original complaint was filed within the applicable statutory period. However, the court dismissed the government's FCA claims, but granted a 30-day leave to amend the Complaint.

The Complaint Was Filed Within the Applicable Statute of Limitations Period

The court observed that a relator's complaint cannot be dismissed without the government's consent, and that if the government files a complaint in intervention, then the government's complaint is seen as an amendment to the original complaint, rather than as a completely new complaint. When the government chooses to intervene, there is no changing of party, or naming of party against whom a claim is asserted, since the relator was merely filling in for the government until the government determined whether to intervene. The court further held that the only section of Fed.R.Civ.P. Rule 15 that was applicable to the complaint at issue was Rule 15(c)(1)(B), which states that an amendment

"relates back" when it asserts a defense or claim that arose out of the transaction, conduct, or occurrence set out, or attempted to be set out, in the original pleading. Furthermore, the court noted that this rule does not contain a notice requirement. Consequently, the court held that the FCA allegations brought in the government's complaint all arose from the same transaction, conduct, or occurrence set out in the relator's original pleading, which was filed within three years of the alleged conduct. Therefore, the court held that the government's complaint was filed within the applicable statute of limitations period. Additionally, the court found that even if notice was required, the defendants had to have been aware of the potential suit based upon the criminal prosecution of one of its employees for involvement in the alleged scheme at the heart of this suit. Accordingly, the defendants' motion to dismiss for failure to satisfy the statute of limitations period was denied.

The Government's Complaint Failed to Meet the Particularity Requirement of Fed.R.Civ.P. 9(b)

The defendants argued that the government's complaint only contained general allegations, and thus the government failed to plead any of the FCA and fraud causes of action with the necessary specificity. The court stated that a detailed report of the alleged scheme to defraud Medicare had been set out in the complaint. However, the complaint failed to identify specifics regarding dates and people involved. The court also found that the complaint did not describe the time, place, and nature of the false statements, or the identities of the parties to the misrepresentation. In addition, the court found that the complaint failed to allege the involvement of one of the defendants with specificity. Since the complaint failed to state the allegedly false claims with sufficient particularity to satisfy the heightened standard of Fed.R.Civ.P. 9(b), the FCA and common law fraud claims were dismissed. However, the government was granted leave to amend the complaint.

U.S. ex rel. Lewis v. Walker, 2008 WL 2817091 (M.D. Ga. July 18, 2008)

Relators filed *qui tam* action against the defendants, a research foundation of a university, its then vice president, and others, alleging that the defendants violated the FCA since the foundation's vice president, in his official capacity, knowingly authorized a false and fraudulent application for the grant of Federal EPA Funds. The relators further alleged that the foundation was liable for the acts of its vice president, since he was an employee, acting in his official capacity. Initially, the relators did not identify the vice president by name, and as a result, the court dismissed the claims against the foundation, since the complaint contained no verifiable allegations that the foundation

actually employed the vice president. The relators amended their complaint by identifying the vice president, and moved the court to reconsider its dismissal of the claims against the foundation. The defendants moved to dismiss the relators' claims, arguing that the relators did not plead their claims with the particularity required in Fed.R.Civ.P. 9(b). The court held that the relators had alleged that the defendants at least "acted in reckless disregard of the truth or falsity of the information," pursuant to FCA section 3739(b), and therefore denied the defendants' motion to dismiss and granted the relators' motion to reconsider.

Relators, David L. Lewis, Ph.D., R.A. McElmurray, and G. William Boyce, filed a *qui tam* action against various individual defendants and the University of Georgia Research Foundation. One of the individual defendants was identified as the vice president of the foundation, but was not identified by name. The complaint alleged that the defendants violated the FCA, because the foundation's vice president, acting in his official capacity, knowingly authorized an application containing false and fabricated information regarding compliance with the Federal Grant and Cooperative Agreement Act (FGCA). The relators alleged that the vice president's acts should be imputed to the foundation. The United States District Court for the Middle District of Georgia initially found that Relators failed to state a claim against the foundation, since their complaint did not identify the vice president and therefore provided no factual allegations that the foundation was connected to that defendant. Subsequently, the relators amended their complaint by adding the identity of the vice president—Joe L. Key—and moved for reconsideration of the court's order dismissing the foundation. The defendants moved to dismiss the complaint, alleging that the relators did not meet the particularity requirements of Fed.R.Civ.P. 9(b). The court denied the defendants' motion to dismiss and granted the relators' motion for reconsideration, finding that the relators successfully demonstrated that the foundation at least "acted in reckless disregard of the truth or falsity of the information," pursuant to FCA section 3739(b).

Relators Satisfied The Particularity Requirement Of Fed.R.Civ.P. 9(b)

The court easily resolved the Rule 9(b) issue, since the court had previously determined that the relators had sufficiently alleged facts that showed that the grant application at issue constituted a "false record." The court also found that the relators had also specifically claimed that Key "authorized" and "signed" the application. Therefore, the court determined that the relators had alleged sufficient facts to demonstrate that Key caused a false record to be made or used. Additionally, the defendants did not dispute that they intended for the Government to pay or approve the claim. Consequently, the only real issue before the

court was whether the foundation had knowledge of the false statements contained in the application. The relators alleged that an Inspector General report from 1993 found that foundation had previously violated the FCGA Act in the submission of previous grants and agreements. The court used this information, combined with the fact that Key, as the foundation's vice president, signed the 1999 grant application, to make its determination. The court found that the relators sufficiently stated a claim that the foundation at least "acted in reckless disregard of the truth or falsity of the information" relating to their compliance with the FCGA Act, and that the relators raised a reasonable expectation that discovery would reveal evidence of the foundation's reckless disregard of the truth or falsity of the information found in the application. Therefore, the court denied the motion to dismiss claims against the defendants.

Imputed Knowledge Under The FCA

The court held that in FCA cases, an employee's knowledge is imputed to its corporate employer when the employee's acts are within the scope of his employment, and when the employee acts for the benefit of the corporation. The court found that the relators demonstrated that Key acted within the scope of his employment with the foundation when he engaged in conduct that allegedly violated the FCA. Therefore, the court held that the relators stated a claim against the foundation. Accordingly, the defendants' motion to dismiss was denied.

The court also granted the relators' motion for reconsideration, based upon its findings related to the denial of the motion to dismiss, and the foundation was reinstated as a defendant in the action.

U.S. v. Pekin Memorial Hospital, 2008 WL 2705443 (C.D. Ill. July 9, 2008)

Relator filed a *qui tam* action alleging common law claims and violations of multiple sections of the False Claims Act against the defendant hospital. The relator's complaint alleged that the defendant intentionally miscoded certain procedures and committed other acts of fraud against the United State's Medicare program. Initially, the defendant filed a motion to dismiss the complaint on the ground that the relator's complaint failed to comply with the particularity requirement of Fed.R.Civ.P. 9(b). The court granted the motion, and found that although the relator had described the allegation with necessary particularity, she failed to describe the individuals involved in the fraud. The court also granted the relator leave to amend the complaint to include the specific details of the people involved. The relator filed the present second amended complaint and the defendant filed a new motion to dismiss, as well as a motion to reconsider. The court granted the defendant's motion to dismiss plaintiff's common law claims, without preju-

dice. However, the court found that defendant's reliance on new case law was misplaced, and that plaintiff could be held to a relaxed Fed.R.Civ.P. 9(b) standard, since she did not have access (before discovery) to specific details related to her claim, based on events that occurred over a period of 18 years. Accordingly, the defendant's motion to reconsider was denied.

Relator, Deborah Landrith, worked for the defendant, Pekin Memorial Hospital, as a billing coder specialist from 1984 through 2002, and was involved in Medicare billing for the defendant. Over the course of this 18-year period, Landrith became aware of illegal billing practices and other fraudulent acts committed by the defendant that were prohibited by Medicare. She brought a *qui tam* action against Pekin, alleging fraud committed against the Medicare program. Pekin filed a motion to dismiss on the grounds that the complaint failed to fulfill the particularity requirements of Fed.R.Civ.P.9(b). The court found that the complaint had sufficiently described the alleged fraud but failed to describe the individuals involved in the fraud. The court granted the motion to dismiss with a leave for Landrith to amend her complaint.

Subsequently, Landrith filed a second amended complaint, which alleged that Pekin violated the FCA on a number of counts: (1) by falsely coding routine preoperative testing as diagnostic testing so that the procedures would be covered by Medicare; (2) by directing the billing coders to fraudulently code all prostate tests so that the defendant would be reimbursed for all prostrate screening tests; (3) by directing the billing coders to fraudulently code all mammograms so that the test would be covered by Medicare; and (4) by forging signatures on claims submitted to Medicare. Landrith also asserted common law claims. Pekin filed a new motion, seeking to dismiss Landrith's common law claims, and also filed a motion to reconsider the court's previous ruling based on new case law.

Plaintiff Fulfilled The Particularity Requirements Of Fed.R.Civ.P. 9(b)

The court found that several sister district courts have allowed a more lenient standard for pleading fraudulent transactions that occurred over a long period of time, or were complex in nature. The court determined that the fraud alleged by Landrith was committed over a period of 18 years, and it was not practically possible for her to describe each instance of fraud, or to provide the names of all of the people whose tests were miscoded, and that a relaxed pleading standard should apply. The defendant argued that the court should refrain from applying relaxed standards under Fed.R.Civ.P. 9(b) based on the Seventh Circuit's decision in *United States ex rel. Fowler v. Caremark RX, LLC,* 496 F.3d 730 (7th Cir. 2007). The court, however, rejected the defendant's argument, finding that the ruling in *Caremark* did not change the applicability of leniency standards in the present case, since, in that case, the appellate court did not discuss the period

of time over which the fraud in that case was committed. Consequently, the court denied defendant's motion to reconsider and held that the Fed.R.Civ.P. 9(b) standard could be altered when the relator, prior to discovery, did not have access to the information required to provide sufficient details. The defendant's Motion to Reconsider, based on new case law, was denied. The court ordered the case to proceed to the discovery phase.

Plaintiff Lacked Standing To Bring Common Law Claim On Behalf Of The Government

The court held that relators may not assert common law claims on behalf of the government under the FCA. The court noted, though, that the government could have intervened and brought common law claims, but chose not to do so. Thus, the relator's common law claims were dismissed. However, the relator argued that the government could reconsider intervening in the case at a later stage, and could reinstate the common law claims at that later date, and so her common law claims should be dismissed without prejudice. The court agreed and dismissed the common law claims without prejudice.

U.S. ex rel. Gagne v. City of Worcester, 2008 WL 2721198 (D. Mass. July 9, 2008)

Relators, Edward L. Gagne and Linda Jeneski, brought a *qui tam* action against the City of Worcester, Massachusetts and a city and city official, alleging that the defendants violated the sections 3729 (a)(1), (a)(2), and (a)(3) of the FCA by misusing and diverting federal grant funds from their purported use to other city projects. Relators also alleged that the defendants defrauded, conspired to defraud, fabricated and submitted false records to the United States government, all in violation of the FCA. The United States District Court of Massachusetts held that relators failed to plead their claims with the particularity required by Fed.R.Civ.P. 9(b). Therefore, the court dismissed all the relators' FCA claims. Relators then filed a motion for reconsideration under Fed.R.Civ.P. 59(e), arguing that Fed.R.Civ.P. 9(b)'s particularity requirements did not apply to claims brought under FCA sections 3729(a)(2) and (a)(3). The court disagreed, and denied the relators' reconsideration motion, finding that the First Circuit has dismissed section 3729(a)(2) claims for failure to satisfy Rule 9(b). The court acknowledged that the First Circuit has not yet addressed the applicability of Rule 9(b) to a 3729(a)(3) claim, but noted that other circuits have found that the particularity requirements of Rule 9(b) apply to section 3729(a)(3) claims. Thus, the court dismissed the (a)(3) claim as well.

U.S. ex rel. Snapp, Inc. v. Ford Motor Co., 2008 WL 2663746 (6th Cir. July 9, 2008)

Relator brought a *qui tam* action alleging that the defendant motor company fraudulently exaggerated the extent of its dealings with small and minority-owned businesses. The relator's original complaint alleged that the defendant used the relator—a purported minority-owned company that was allegedly controlled entirely by the defendant—as a conduit for passing money through to the defendant's large, majority-owned subcontractors, and thus violated the False Claims Act by misrepresenting the extent of its dealings with small and minority-owned businesses in order to fraudulently induce the federal government to award contracts to the defendant. The relator alleged that every claim the defendant submitted to the government based on the contracts at issue was false. After the district court dismissed the relator's original complaint for failure to comply with Rule 9(b), the relator filed a first amended complaint and submitted copies of annual reports the defendant submitted to the government in order to retain its eligibility as a government contractor. The district court dismissed the first amended complaint as well. The relator moved for reconsideration and for leave to file a second amended complaint and additional new evidence. The district court denied the motion and the relator then appealed to the Sixth Circuit. The Sixth Circuit affirmed the Eastern District of Michigan's decision, which dismissed the relator's complaint for failure to plead fraud with particularity. However, the Sixth Circuit vacated the district court's order denying the relator leave to file an amended complaint—that matter was remanded to the district court.

The Sixth Circuit determined that while the relator, Snapp, Inc., identified defendant Ford Motor Company's allegedly false statements, it failed to identify even a single claim for payment that Ford submitted to the government. The court held that it was insufficient for the relator to allege generally that all of the defendant's claims, for an undetermined number of contracts, were false. The court held that "[w]hen a relator alleges such a 'complex and far-reaching fraudulent scheme' to induce the government into making payments," the relator's complaint must "include specific examples of the defendant's claims for payment from the federal government." Since Snapp did not provide any examples of claims Ford submitted to the government, the Sixth Circuit affirmed the district court's decision dismissing the first amended complaint. However, the circuit court vacated the district court's decision denying Snapp's motion to file a second amended complaint. Although it recognized that the issue was completely within the district court's discretion, the circuit court subtly encouraged the district court to allow the relator to file a second amended complaint. The circuit court observed that the district court denied the relator's motion

prior to the circuit court's decision in *U.S. ex rel Bledsoe v. Cmty. Health Sys., Inc.*, 501 F.3d 493 (6th Cir. 2007) (known as *Bledsoe II*), and prior to the Supreme Court's decision in *Allison Engine v. U.S. ex rel. Sanders,* ___ S.Ct. ___, 2008 WL 2329722 (June 9, 2008), which are directly on point. In *Bledsoe II*, the circuit court made clear that a relator who alleges a "complex and far-reaching fraudulent scheme" need only provide examples of specific false claims submitted to the government, in order to proceed to discovery," and it appeared that the relator's second amended complaint may have provided overcome this hurdle. In addition, in *Sanders*, the Supreme Court ruled that *qui tam* plaintiffs may only prevail upon a showing that the defendant made a false statement *with the purpose* of getting the government to pay or approve a false claim. The circuit court reasoned that since Rule 9(b) exempts allegations of intent and knowledge, relators do not have to plead that defendants acted with a particular purpose—again implying that the relator's second amended complaint might pass muster on remand.

Raghavendra v. Trustees of Columbia Univ., 2008 WL 2696226 (S.D.N.Y. July 07, 2008)

Plaintiff, Rajagopala Raghavendra, filed a *qui tam* action against his former employer, the Trustees of Columbia University, and certain individual defendants, who were employees of the university, alleging employment discrimination. He also alleged that the defendants violated FCA section 3729 by falsely claiming to be an "Equal Opportunity" employer, and by falsely claiming to maintain affirmative action programs. Defendants filed a motion to dismiss the complaint.

The court determined that the plaintiff's FCA allegations were inadequate under Fed. R. Civ. P. 9(b) and that his complaint should be dismissed for vagueness, and failure to state when or how the University defrauded the government, who made false statements to the government, and what false information those statements contained. Relying on the Supreme Court's ruling in *Allison Engine Co. v United States*, --- S. Ct. ----, No. 07-214, 2008 WL 2329722, (June 9, 2008), the court found that in order to sufficiently state an FCA claim, the plaintiff must have alleged that the defendant's intention, in making the false statement, was to defraud the government. The mere fact that the University received federal funding, combined with the plaintiff's dissatisfaction with his treatment by the defendants, did not constitute an adequate FCA claim or allegation. Thus, the plaintiff's FCA claim was dismissed.

See *U.S. ex rel. Lusby v. Rolls-Royce Corp.* 2008 WL 4247689 (S.D. Ind. Sep. 10, 2008), at page 32.

A. Rule 12(b)(6) Failure to State a Claim upon Which Relief Can Be Granted

U.S. ex rel. Sterling v. Health Ins. Plan of Greater New York, Inc., 2008 WL 4449448 (S.D.N.Y. Sep. 30, 2008)

The relator filed a complaint against her former employer, a corporation providing health benefits and health management services. She alleged violations of sections 3729(a)(1), (a)(2) and (a)(3) of the FCA, based on the allegation that the defendant defrauded the government by altering data to obtain an accreditation from an independent agency, which the defendant needed to maintain its contract with the government to provide health benefits to federal employees. The government declined to intervene in the case. The defendant moved to dismiss the complaint. The United States District Court for the Southern District of New York granted the defendants' motion, and held that the relator did not allege a false claim or conspiracy under the FCA.

Failure To State A Claim

The court, relying on the Supreme Court's decision in *Allison Engine Co. v. United States ex rel. Sanders,* 128 S.Ct. 2123 (2008), held that there must be a direct link between a false statement and the government's decision to pay. Hence, the court held that the relator's allegation that the defendant fraudulently altered data in order to obtain accreditation from an independent, non-governmental accrediting agency did not constitute a false claim under section 3729 (a)(2) of the FCA. The court found that the allegedly altered data was intended to deceive only the accrediting agency and not the government. Furthermore, the fact that the government relied on the accreditation to continue contracting with the defendant did not establish a direct link between the defendant's alleged fraud and the government's decision to pay. Likewise, the court held that the relator did not allege a claim under Section 3729(a)(1); the defendant's presentment of the allegedly false data to the accreditation agency was not presentment to the government under the FCA, since the accreditation agency was a separate and independent entity from the government.

Finally, the court dismissed the relator's conspiracy claim under the FCA. It found that in the relator's only specific allegation of fraud in the complaint, she mentioned the name of only one person. Since a conspiracy claim requires that two or more people participate, the court held that the relator failed to state a claim in this regard.

U.S. ex rel. Lacy v. New Horizons, Inc., 2008 WL 4415648 (W.D. Okla. Sep. 25, 2008)

Plaintiff brought a *qui tam* action against companies and individuals managing intermediate care facilities for mentally disabled adults. The plaintiff's first amended complaint was dismissed because it was not pled with particularity. The plaintiff then filed a second amended complaint alleging presentment of false claims, usage of fraudulent reports, conspiracy, anti-kickback violations and retaliatory discharge. The United States District Court for the Western District of Oklahoma held that the plaintiff's complaint was again deficient, since, with respect to almost all of the allegations, the plaintiff failed to state a claim for relief under the FCA. Thus, the court dismissed much of the plaintiff's second amended complaint. However, the court found that one of the plaintiff's claims could possibly satisfy the pleading requirements and the court granted the plaintiff leave to amend that claim only.

Failure to State a Claim Under the FCA

The court dismissed the plaintiff's claims alleging false certifications of statutory compliance, finding that those allegations did not state a claim for relief. The plaintiff had argued that defendants' submission of reports certifying compliance with statutory requirements represented both an express and an implied false certification to the government. The court held the alleged certifications were required only to be eligible for participation in the medical program and did not constitute conditions for government payments. The court agreed and held that this claim did not constitute a viable action for false payment under FCA. The plaintiff's claims of anti-kickback violations were also dismissed for failure to state a claim, since the plaintiff failed to present an offer of payment and/or a solicitation or receipt of payment that could constitute a kickback. Moreover, the court found that the plaintiff's allegations that the defendants falsely certified compliance with Medicare regulations could not be a basis for an FCA claim, because compliance only affected participation in the Medicare program and was not a basis for reimbursement. Hence, the court held that these allegations failed to plead a claim for payment because no relationship between the alleged fraud and a claim for payment was made. Likewise, the court dismissed the plaintiff's conspiracy claim, finding that it was barred by the intracorporate conspiracy doctrine. The court found that the defendants and their employees, who were acting as the agents of the defendants, constituted a single entity and could not possibly form a conspiracy. Thus the plaintiff's conspiracy claim could not be maintained. After the court dismissed these substantive FCA claims, it dismissed the plaintiff's retaliation claim as well. The court reasoned that since the substantive violations alleged by the plaintiff could not have constituted a viable FCA claim, it followed that the plaintiff's reporting of those purported violations to any of the defendants could not be a protected activity under the

FCA. Hence, the court held that the plaintiff's claim for retaliatory discharge was not actionable under the FCA.

The court did find, however, that the plaintiff's allegations regarding per diem billing came close to stating a cognizable claim. The plaintiff had identified specific patients who may have been inappropriately billed for, and had specified some of the dates and dollar amounts involved. Consequently, the court granted the plaintiff leave to again amend the complaint and provide additional factual details, including the specific facilities involved, the dates on which the alleged over-billing occurred, how many patient days were over-billed for, and an estimate of the amount over-billed for each patient.

U.S. ex rel. Mason v. State Farm Mut. Auto. Ins. Co., 2008 WL 2857372 (D. Idaho July 23, 2008)

Plaintiffs filed a complaint against an automobile insurance company, alleging that the defendant violated the FCA. One of the Plaintiffs ("Plaintiff 1") was insured by the defendant and incurred substantial medical expenses, including expenses related to a spinal surgery, following a car accident. The defendant disputed its duty to pay Plaintiff 1's medical bills, and Plaintiff 1 hired Plaintiff 2—an insurance coverage attorney—to help him obtain coverage. After an independent medical examination, it was determined that the defendant insurance company was liable for sixty percent of Plaintiff 1's medical bills. Eventually, the defendant began to pay Plaintiff 1's medical bills. However, the defendant never paid the bill for Plaintiff 1's back surgery. The hospital that performed the surgery requested payment from Medicare, and Medicare made a contingent payment. The plaintiffs alleged that the defendant, by neglecting to pay the spinal surgery bill, caused the hospital to seek payment from Medicare in violation of the FCA. The defendant moved to dismiss the plaintiffs' complaint for lack of subject matter jurisdiction, failure to state a claim, and failure to plead with the specificity required under Fed.R.Civ.P. 9(b). The court denied the defendant's motion, on the subject matter jurisdiction grounds, granted the defendants' motion, without prejudice, on failure to state a claim and failure to plead fraud with specificity grounds. The court also granted the plaintiffs leave to amend the complaint.

Eugene Mason was involved in an automobile accident and was duly covered under an insurance policy with the defendant, State Farm Mutual Automobile Insurance Company. State Farm disputed its duty to pay medical bills under Mason's policy, and Mason hired Patrick Brown, an insurance coverage attorney, to assist him in obtaining coverage from State Farm. An independent medical examination determined that State Farm's financial liability was sixty percent of Mason's medical treatment. State Farm then began paying Mason's medical bills. State Farm paid for some of the medical services, but did not pay for the bill for

a spinal surgery Mason underwent. Mason was eligible for Medicare, and the hospital that performed the surgery later requested payment from Medicare. Medicare made a contingent payment to the hospital. The plaintiffs then filed suit against State Farm, alleging that the insurance company violated the FCA by causing the hospital to submit a false claim to Medicare to cover the bill for Mason's spinal surgery. The4 plaintiffs further alleged that State Farm committed a reverse false claims violation, by knowingly concealing its obligation to repay Medicare for the money that had been spent to pay for Mason's surgery. State Farm moved to dismiss the complaint for lack of subject matter jurisdiction, failure to state a claim, and failure to plead with the specificity required under Fed.R.Civ.P. 9(b). The United States District Court for the District of Idaho denied the motion on lack of subject matter jurisdiction grounds, but granted the motion, without prejudice on the grounds that the plaintiffs failed to state a claim and failed to plead fraud with specificity. The court also granted the plaintiffs leave to amend their Complaint.

State Farm's Motion to Dismiss for Lack of Subject Matter Jurisdiction Was Denied

State Farm argued that there was no false claim, and even if there was, it had no knowledge of it. The court observed that the substantive and jurisdictional elements were sufficiently intertwined for the court to treat State Farm's motion to dismiss for lack of subject matter jurisdiction as a motion to dismiss for failure to state a claim under Fed.R.Civ.P. 12(b)(6). Therefore, State Farm's motion to dismiss for lack of subject matter jurisdiction was denied and the court turned to State Farm's Rule 12(b)(6) and Rule 9(b) grounds.

The Complaint Failed to State a Claim Under Fed.R.Civ.P. 12(b)(6)

Presentment:
The plaintiffs alleged that State Farm caused the hospital to submit a false Medicare claim when it denied liability and refused to pay Mason's medical bills associated with his spinal surgery. State Farm contended that it was not aware of an alleged duty to pay the bill for the spinal surgery. The court observed that the complaint failed to allege when and if State Farm received a surgery bill, or that State Farm had refused to pay it. Therefore, the court found that the complaint failed to allege a cause and effect relationship necessary to state a claim under the FCA.

"False" or "Fraudulent" claim:
The court determined that the in order to maintain their cause of action, the plaintiffs needed to allege that the claims submitted to Medicare by the hos-

pital contained false misrepresentations or statements. State Farm contended that the hospital's claim to Medicare was not fraudulent, because the hospital had a statutory right to submit a bill to Medicare for Mason's bills. The plaintiffs countered that the hospital's claim was fraudulent, because State Farm—not Medicare—was primarily liable for Masons' medical expenses. Therefore, the plaintiffs argued, any request for payment of those covered expenses from Medicare was fraudulent. The court found that the plaintiffs failed to demonstrate that the hospital used false information to receive the Medicare payment. Therefore, the court held that the plaintiffs failed to adequately plead the false claim element.

Knowledge:
The court held that in order to maintain their cause of action, the plaintiffs needed to show that State Farm had received the bill for Mason's surgery and did not pay it, knowing that doing so would cause the hospital to bill Medicare. If the hospital did not have specific knowledge of the bill, then the plaintiffs needed to allege facts that showed that State Farm recklessly ignored information that would have given it knowledge. State Farm contended that it did not knowingly cause the hospital to submit the alleged false claim and that its alleged duty to cover that expense was in dispute. Thus, State Farm argued, there was no "knowing" falsity under the FCA. The plaintiffs alleged that the State Farm had specific knowledge of its liability or, at the very least, it should have known of its liability. The court, however, disagreed with the plaintiffs' assessment and observed that the plaintiffs' complaint failed to show that the State Farm knowingly caused the hospital to bill Medicare. In addition, the court found that the plaintiffs' complaint failed to show that State Farm deliberately ignored the surgery bill, or that it acted with reckless disregard. Accordingly, the court held that the plaintiffs failed to demonstrate "knowledge" as required under the FCA.

As a result of these findings, the court granted State Farm's motion to dismiss the complaint for failure to state a claim. However, the complaint was dismissed without prejudice.

Plaintiffs' Reverse False Claim Allegation Failed

False statements:
To prove a violation of the reverse false claims provision, the plaintiffs' complaint must have alleged that State Farm had a mandatory obligation to reimburse Medicare, and that it made false statements while this duty existed. The court found that the complaint sufficiently alleged that State Farm was liable for reimbursing Medicare (according to statute), and that the complaint sufficiently alleged false statements or misrepresentations by State Farm. Therefore, the court held that the plaintiffs' allegations were sufficient to trigger a reverse false claim. However, the court's analysis did not stop there.

Causation:
State Farm argued that the alleged false statements were directed to Brown, and not to the government or the hospital, and therefore could not have caused Medicare to lose money. State Farm further contended that it could not have avoided a duty to pay Medicare, since it was not aware of any duty to pay. The court observed that the plaintiffs needed to allege that State Farm made the false statements to the plaintiffs in order to avoid repaying Medicare, and that this was done knowingly. However, the court found that the complaint failed to show that State Farm had knowledge of a duty to reimburse Medicare. Therefore, the court found that any of State Farm's allegedly false statements could not have been said knowingly in order to avoid payment. The court further held that the complaint failed to establish how State Farm's statements caused the government to not be reimbursed. Accordingly, the court held State Farm's allegedly false statements, by themselves, were insufficient to state a violation of the FCA. Therefore, the court granted State Farm's motion to dismiss, without prejudice, for failure to state a claim.

Pleading Fraud with Specificity:
Plaintiffs argued that Fed.R.Civ.P 9(b) did not apply to reverse false claims, because the FCA fraud is different from the common law fraud addressed under Fed.R.Civ.P 9(b). The court, however, had already determined that the plaintiffs failed to state a claim under Fed.R.Civ.P 12(b)(6). This finding led the court to hold that the plaintiffs failed to plead the alleged facts of fraud with the particularity required in Fed.R.Civ.P 9(b). The court also held that the complaint failed to meet even the relaxed pleadings requirements. Although the plaintiffs outlined State Farm's alleged plan of fraud, they failed to make out the elements of causation or knowledge necessary to state a claim or, to state facts on which the belief was based. Therefore, State Farm's motion to dismiss for failure to plead fraud with specificity was granted, without prejudice.

B. Rule 15 Relation Back Doctrine

Makro Capital of America, Inc. v. UBS AG, 2008 WL 4402701 (11th Cir. Sep. 30, 2008)

Plaintiff filed a complaint against the defendant company alleging, among other things, fraud and misrepresentation. In the same complaint, the plaintiff asserted an unjust enrichment claim against the government. The claims arose out of a settlement between a predecessor of the defendant company and the United States after the government seized assets of the company during World War II. The complaint was dismissed without prejudice. The plaintiff then filed an amended complaint that alleged the same facts but put forth FCA claims against the defendant. Specifically, the amended complaint alleged that the defendant's predecessors mischaracterized facts that resulted in the improper receipt of settlement money from the government. Meanwhile, before the plaintiff's amended complaint was filed, another relator filed a *qui tam* action against the defendant based upon the same facts as those in the plaintiff's original complaint. When both complaints were unsealed, the defendant moved to dismiss the plaintiff's complaint for lack of subject matter jurisdiction, on the grounds that the plaintiff's *qui tam* action was not the first *qui tam* action based on the alleged facts and that the government had information regarding the alleged false claims before the plaintiff's claim was filed. The District Court for Southern District of Florida granted the motion to dismiss. The plaintiff then moved for reconsideration arguing that Fed.R.Civ.P 15 allowed its amended complaint to relate back to the original complaint, and that, as a result, the plaintiff's original complaint was first. The court denied the motion and the plaintiff appealed the decision to the 11th Circuit Court of Appeals. The appellate court affirmed.

Plaintiff's Complaint Did Not Relate Back Under Fed.R.Civ.P 15

The plaintiff argued that, under Fed.R.Civ.P. 15, its amended complaint related back to the date of its original complaint, since the amended filing relied on the same factual basis as the original pleading and since the defendant had sufficient notice and knowledge of the potential *qui tam* action so that no prejudice would result. The court rejected this argument, holding that a pleading can only relate back if a defendant would have had knowledge of the existence of the subsequent claim in the allegations of the original complaint. The court found that the plaintiff's *qui tam* action, especially since the government was named as a *defendant,* was so divergent from the original complaint that it did not relate back to original complaint. The court stated that "[t]here is an intrinsic distinction between a non-*qui tam* action brought against the United States and other parties and a *qui tam* suit brought on behalf of the United States against its former co-defendant." For the same reasons, the court found that the defendant

would not have been on notice of the plaintiff's *qui tam* claim. The court also found that permitting *qui tam* claims to relate back to non-*qui tam* claims would frustrate the purpose of the FCA by allowing multiple private suits in situations where the government has chosen not to act. Accordingly, the court affirmed the decision of the district court.

LITIGATION DEVELOPMENTS

A. Appellate Issues

U.S. ex rel. Eisenstein v. City of New York, 2008 WL 3840447 (2nd Cir. Aug. 19, 2008)

A group of relators filed a pro se *qui tam* suit against the City of New York and Mayor Bloomberg in the U.S. District Court for the Southern District of New York, alleging that the city violated the FCA by requiring non-resident city employees to pay a fee equivalent to the city taxes paid by city employees who were residents. The relators' theory was that the federal government was being deprived of tax revenue because non-resident city employees who were required to pay the fee could take a tax deduction for the fee, and thereby reduce their taxable income. The federal government declined to intervene and the district court dismissed the relators' complaint for failure to state a claim. The relators filed a notice of appeal 54 days later. The circuit court then asked both the relators and the United States to explain whether the typical 30-day time limit for filing a notice of appeal applied, or whether the 60-day time limit (which is reserved for appeals in which the United States is a party) applied. Soon after, the city moved to dismiss the appeal, arguing that the notice of appeal was not filed in time.

The circuit court, after reviewing Federal Rule of Appellate Procedure 4(a)(1), held that the extended 60-day time limit only applies when United States is a "party." The court noted that "the word 'party' refers to the person participating in the proceedings with control over the litigation." Notwithstanding the fact that all *qui tam* cases are brought in the name of the United States and that the United States, as the "real party in interest," must still approve the settlement of any non-intervened *qui tam* case, the circuit court held that the United States is not a party to non-intervened cases. The court's reasoning was based on the fact that: (1) once the United States declines intervention, it can only intervene upon a showing of good cause; (2) the United States is no longer served with pleadings in non-intervened cases, unless it specifically requests to be served; and (3) the United States is not liable for any expenses incurred by a relator who proceeds in a non-intervened case. The court rejected the relators' argument that the United States was necessarily a party, since it was the real party in interest to the litigation. The court also rejected the respective holdings of other circuit courts and determined that "the United States' status as a real party in interest is by itself insufficient to trigger the 60-day filing period." The Second Circuit reasoned that Rule 4(a) could have explicitly specified that the 60-day period

applies to situations where the United States is either a party or the real party in interest, but it does not. The court further declared that "the term 'real party in interest' exists only to distinguish the litigation interest it covers from those of a 'party' who is the person responsible for prosecuting the action." Thus, the court held, for purposes of Rule 4(a), the United States was not a "party" to the litigation, since it "played no role in this matter before the district court." Consequently, since Rule 4(a) confers subject matter jurisdiction on appellate courts, the circuit court determined that it was without authority to hear the relators' appeal, since their notice of appeal was filed out of time.

In addition, although the circuit court did not reach the issue, in a footnote referencing its decision in *U.S. ex rel. Mergent Servs. & John Bal*—a case decided on the same day (and discussed below)—the court also mentioned that relators are barred from pursuing FCA actions as *pro se* litigants, which would have provided another grounds for affirming the district court's decision and for dismissing the relators' appeal.

B. Calculating Damages

U.S. v. United Technologies Corp., 2008 WL 3007997 (S.D. Ohio. Aug. 1, 2008)

The government filed a complaint asserting allegations against the defendant corporation for violating the FCA, as well as for common law fraud, breach of contract, payment by mistake, and unjust enrichment. The government alleged that the defendant concealed relevant materials when it submitted a cost estimation. The United States District Court for the Southern District of Ohio concluded that each invoice the defendant submitted to the government constituted a violation of the FCA, and awarded damages under the FCA in the amount of $10,000 per invoice submitted, for a total of $7,090,000. The court's rationale, in part, stemmed from its application of the "natural tendency" test. Under this test, focus is placed, not on the actual effect of the false statement when it is discovered, but rather, on the false statement's potential effect at the time it was made. Additionally, under the test, materiality is presumed if the "natural tendency" of the false statement has the potential effect of causing the payment of a false claim. The court observed that the probable and natural consequence of defective pricing data is to cause an overstated price, and thus found that each invoice submitted by the defendant violated the FCA, since the defendant knowingly made a false statement or record to get a fraudulent or false claim paid by the government. Although the defendant argued that the government did not rely on the false assertions, the court held that reliance is not an element of a cause of action under the FCA.

C. Circumstantial Evidence

U.S. ex rel. Pogue v. Diabetes Treatment Centers of America, 2008 WL 4277153 (D.D.C. Sep. 19, 2008)

The relator filed a *qui tam* action against a medical treatment center company, various directors, and affiliated hospitals. The complaint alleged that the defendants were involved in a fraudulent scheme of hiring medical directors and paying them to generate referrals to the treatment center. The defendant treatment center moved for summary judgment which was granted in part and denied in part by the United States District Court for the District of Columbia. In particular, the district court held that direct claim evidence relating to 89 of the 276 medical directors was sufficient evidence of claim submission in general for the court to allow claims against the remaining 187 medical directors. Subsequently, the treatment center moved to reconsider that portion of the court's opinion. Using the same reasoning, the court denied the defendant treatment center's motion to reconsider. It also denied the defendant's motions for certification of the denial of summary judgment and to reopen discovery.

Circumstantial Evidence

The relator produced Medicare claim evidence regarding 89 of the 276 medical directors involved in the case. The defendant contended that summary judgment should be granted in the absence of direct evidence as to each specific director's claim submissions. The court disagreed and held that evidence of fraud as to a subset of individuals can create a genuine issue of material fact as to a related subset of individuals. Accordingly, the claim evidence relating to a subset of medical directors created circumstantial evidence sufficient to create a genuine issue of material facts as to the entire subset of medical directors. The court cautioned, however, that this approach is not appropriate in all cases and was applicable in this case because the relator alleged a scheme of hiring medical directors and paying them to generate referrals to the medical center. Hence, it found that the evidence of fraud was not in the claim forms themselves but in the relationship between the medical directors and the medical center. Accordingly, the court denied the motion to reconsider the summary judgment order.

D. Government Employee Relators

See *U.S. ex rel. Maxwell v. Kerr-McGee Oil & Gas Corp.*, 2008 WL 4149638 (10th Cir. Sep. 10, 2008), at page 16.

E. *Pro Se* Relators

U.S. ex rel. Mergent Services v. Flaherty, 2008 WL 3840769 (2nd Cir. Aug. 19, 2008)

The relator, proceeding *pro se,* brought an FCA action in the United States District Court for the Southern District of New York, in which he alleged that the defendant submitted a false receipt to the government in order to receive reimbursement for costs never incurred. The district court dismissed the complaint, and held that *qui tam* actions cannot be brought *pro se*. The relator appealed, and the Second Circuit affirmed the district court's dismissal. The circuit court held that the FCA's provision requiring consent of the Attorney General prior to the dismissal of *qui tam* actions only applies in cases where the relator seeks a voluntary dismissal of an action or claim brought under the FCA, and not where the dismissal is ordered by the court. Moreover, the appeals court held that although relators have a stake in the FCA *qui tam* cases they initiate, the real party in interest is the government, and while relators are permitted to control their FCA litigation, the corresponding claims belong to the government. The court held that since relators lack a personal interest in FCA *qui tam* actions, they are not entitled to proceed *pro se*.

J. Meidinger v. Lee Memorial Hospital, 2008 WL 2704494 (M.D. Fla. July 2, 2008)

Pro se plaintiff J. Meidinger filed a *qui tam* complaint against defendant Lee Memorial Hospital, alleging that the defendant violated the FCA by filing several false Medicare claims. The government declined to intervene in the case. Relying on the Eleventh Circuit's ruling in Timson v. Timson, 518 F.3d 870 (11th Cir. 2008), the United States District Court for the Middle District of Florida dismissed the amended complaint without prejudice, holding that a *pro se* relator can not proceed with a *qui tam* action on behalf of the United States.

See *U.S. ex rel. Eisenstein v. City of New York,* 2008 WL 3840447 (2nd Cir. Aug. 19, 2008), at page 61.

F. Unsealing Pre-Intervention Documents

U.S. ex rel. Schweizer v. Oce, N.V., 2008 WL 4216345 (D.D.C. Sep. 12, 2008)

The relators filed an FCA suit against two companies dealing in print and document management, alleging that the defendants knowingly sold non-compliant products to the federal government in violation of the Trade Agreements Act and breached a contract guaranteeing the government a price equal to or less than the lowest price paid by non-government customers for the same product. The government declined to intervene. Thereafter, the United States District Court for the District of Columbia unsealed the relators' amended complaint. The defendants then moved to unseal all the records filed by the relators. In particular, the defendants aimed to unseal several exhibits to the original complaint, including the defendants' confidential disclosure statement. The court relied on the six factor analysis laid down in *United States v. Hubbard,* 650 F.2d 293 (D.C. 1980) to determine if the motion for unsealing the documents should be granted, and after applying the test, the court ordered that all documents filed by the relators be unsealed.

The court found that the D.C. Circuit has a strong presumption in favor of public access to judicial proceedings. Under *Hubbard,* however, the court found six factors that could overcome this presumption. The court then examined each of *Hubbard*'s factors to determine if they favored unsealing the record.

1) Need For Public Access

The court first discussed the defendants' particular need to unseal the record. A clerical error allowed the defendant to obtain an exhibits list appended to the original complaint. After examining this document, the defendants asserted that they needed to view the relators' documents to respond to the complaint. They believed that several of the sealed exhibits were published articles which could raise subject matter jurisdiction issues. They also asserted that it would be impossible to admit or deny information in the complaint, which apparently was taken from the defendant's own files, without seeing the exhibits. The court held that the defendants asserted a pragmatic, individualized need for access to the sealed record and concluded that this factor favored lifting the seal.

2) Extent Of Previous Public Access

The defendants contended that some of the sealed materials were publicly available. The court found that this factor weighed in favor of unsealing those materials to the extent that they were already in the public domain.

3) Objections To Unsealing

The relators objected to unsealing by contending that the exhibits and confidential disclosure statement filed with the complaint were protected by attorney-client and/or work product privileges. The court analyzed whether the relators had waived those privileges by filing the documents. The court found that in the D.C. Circuit any disclosure, except court-compelled disclosure, is a waiver of privilege. The court then observed that the relators needed only to file the complaint with the court and were under no compulsion to file the exhibits and confidential disclosure statement. Accordingly, the court held that by filing the confidential disclosure statement and exhibits along with their original complaint, the relators had voluntarily waived any privileges that might have attached to these documents. Consequently, the court found that this factor weighed in favor of lifting the seal.

4) Strength Of Asserted Property/Privacy Interests

The court observed that other than the relators' privilege assertions, neither party argued that either property or privacy interests were at stake on this motion. Thus, this factor weighed neither for nor against unsealing the record.

5) Possibility Of Prejudice

The court found the possibility of prejudice to the relators was slight. First, there was no justification in keeping factual allegations from the defendants once the relators' identities were disclosed. Second, since none of the relators remained employed with the defendant, workplace discrimination and harassment would not follow from disclosure of the sealed materials. Finally, the substance of the sealed documents, if not the documents themselves, was likely to be discoverable. Therefore, the possibility of prejudice to the relators did not weigh against unsealing the record.

6) Purpose Of Sealed Materials' Introduction

The court was unable to discern why the relators filed the confidential disclosure statement and exhibits other than to assume that it was to further the prosecution of their claims. Hence, this factor favored unsealing the record.

In sum, the court found that the factors favored unsealing the record and ordered all documents filed by the relators be unsealed.

U.S. ex rel. Becker v. Tools & Metals, Inc., 2008 WL (N.D.Tex. Aug. 19, 2008)

The relator brought a *qui tam* action in the United States District Court for the Northern District of Texas, in which the government intervened. The

court unsealed the relator's joint amended complaint and the government's notice of election to intervene but ordered that all other previously filed papers remained sealed. The defendants then moved to unseal all of the court filings in the case. The relator and the government opposed the unsealing of certain documents. The government opposed the defendants' motion to unseal the "confidential government investigative reports" apparently contained in its applications for extensions of its deadline to determine whether it would intervene in the case. The relator opposed the unsealing of two of its disclosures to the government, on work product privilege grounds. The court determined that it had the authority to unseal filings before the government intervened. It further found that it had wide discretion in determining which documents, if any, should remain under seal, and how to make that determination. The court then ruled that the government's objections to unsealing were not specific to the information included in each application for an extension. Hence, the court ordered the government to review the applications, file specific objections and file proposed redactions, if any, for an *in camera* review in order to properly decide the motion to unseal. The court dismissed the work product privilege argument because the relator cited no case law in support of his contention. The court then ordered that all filings be unsealed except those filings to be reviewed *in camera*.

Judgments & Settlements

JULY 1, 2008–SEPTEMBER 30, 2008

Cooper University Hospital and St. Joesph Healthcare System Inc. Settlement: U.S. ex rel. Kite v. Besler Consulting et al. (D.N.J. October 21, 2008)

Cooper Hospital and St. Joseph's Healthcare System Inc. agreed to pay the United States $3.85 million and $1.75 million respectively to settle allegations that both defendants falsely inflated Medicare and Medicaid patient charges. The alleged result was excessive outlier reimbursements from the United States government in violation of the False Claims Act. Cooper Hospital is a major teaching hospital in Southern New Jersey and St. Joseph Healthcare System Inc. manages a number of medical facilities across northern New Jersey. The defendants allegedly accepted and applied outlier inflation schemes devised by Besler Consulting and Shusko Consulting; the implementation of which purportedly resulted in the excess payment of millions of dollars to which the defendants were not entitled. Besler Consulting previously settled allegations in March 2008 for devising the previously mentioned schemes. The relator, Anthony J. Kite, served as an independent hospital consultant in New Jersey and filed the *qui tam* suit in 2005. He received $654,000 from Cooper Hospital and $481,250 from St. Joseph's Hospital as his share stipulated in the settlement agreements. A number of other hospitals in New Jersey and Pennsylvania who allegedly implemented similar schemes from Besler and Shusko have settled these allegations for more than $22 million thus far. Investigations were handled by the Justice Department's Civil Division, Commercial Litigation Branch; the U.S. Attorney's Office for the District of New Jersey, Affirmative Civil Enforcement Unit; the U.S. Attorney's Office for the Eastern District of Pennsylvania; the Department of Health and Human Services, Office of Inspector General and Office of Counsel to the Inspector General; the Centers for Medicare and Medicaid Services; and the FBI.

Cephalon, Inc. (E.D. Pa. September 29, 2008)

Cephalon, Inc. agreed to pay the federal government and thirteen states a sum total of $425 million to settle allegations of "off-label" marketing Gabitril, Actiq, and Provigil prescription drugs. All three pharmaceutical drugs were previously approved for the treatment of specific medical conditions by the FDA. Cephalon allegedly implemented marketing schemes to promote Gabitril, Actiq and Provigil for non-approved treatments in order to increase the sales base of each product and generate new revenue. Gabitril is solely approved for the treatment of partial seizures for individuals over the age of 12. The approved treatment for Provigil was for excessive sleepiness related to narcolepsy, sleep apnea, and shift work sleep disorder only. Actiq was approved by the FDA as a drug treatment for breakthrough cancer pain. Each drug, through a variety of means, was allegedly marketed for alternate uses than FDA approved. The purported "off-label"

marketing stood in violation of the Food, Drug, and Cosmetics Act and FDA regulations. Additionally, allegations stated that Cephalon provided financial incentives in the form of kickbacks to physicians for speaking on behalf of Gabitril and Provigil for non-approved treatments. The alleged kickbacks and "off-label" marketing resulted in illegitimate billing to Medicaid seeking repayment from the United States and the respective states, which would violate the False Claims Act. The four relators in the case were represented by Frederic Ellis and TAF members Kirk Chapman, Peter Chatfield, Brian Kenny, and David Stone.

U.S. ex rel. McMillan et al. v. General Dynamics Armament and Technical Products Inc. (E.D.N.Y. August 18, 2008)

General Dynamics Armament and Technical Products (henceforth referred to as GDATP) agreed to pay $4 million to settle allegations of purposively selling untested parts to the Navy intended for use in aircraft and submarines. GDATP is a wholly-owned subsidiary of General Dynamics Corporation and operates a facility in Glen Cove, Long Island. At the Glen Cove facility where relators Lourdes McMillan, Charles Palmer, Rudy Tanawots, and David Ginsburg were employed, it was alleged that GDATP manufactured defective parts and deliberately failed to meet testing standards. The components were sold for use on various transport aircraft and two separate types of naval submarines. Additionally, it was alleged that both GDATP and General Dynamics Corporation had knowledge of the failure to meet testing standards and these defective components being sold. Relators' shares totaled roughly 14.3% of the total settlement and defendant's agreed to pay $191,250 for relator's attorney fees and expenses incurred. The complaint was made by relators in August of 2003 and the United States intervened in July of 2007. The allegations were investigated by the United States Attorney's Office and the Defense Criminal Investigative Service, New York.

U.S. ex rel. Thompson et al. v. Walgreen Co. (D. Minn. September 9, 2008)

Walgreen Co. agreed to pay four states and the United States $9.9 million to settle allegations that they knowingly and deceptively improperly billed Medicaid programs. Individuals who are covered by both private party insurance as well as Medicaid do not have to make a co-payment to account for the gap between the total drug cost and the cost covered by the private insurance. Instead, Medicaid is legally obligated to reimburse Walgreens the difference between what the private party insurance pays and total cost of the prescription drug. Rather than seeking reimbursement for the aforementioned amount, Walgreen Co. allegedly billed Medicaid programs to be reimbursed for the full cost an individual would

pay if they did not have private insurance in addition to Medicaid. Walgreen allegedly improperly billed these excess sums knowingly and in violation of the False Claims Act. The alleged result was thousands of false cost claims being submitted by Walgreen to Medicaid since 1998 and continuing to the present. The complaint was brought by two pharmacists Neil Thompson and Daniel Bieurance who were represented by Robert Christensen, James VanderLinden, and TAF member Brian Wojtalewicz. Of the $9.9 million Walgreen Co. has agreed to pay to settle allegations, relators will receive approximately $920,794 on top of reasonable attorneys' fees and expenses. The allegations were investigated by the U.S. Department of Justice and Office of the Inspector General of the Department of Health and Human Services.

Staten Island University Hospital (E.D.N.Y. September 11, 2008)

Staten Island University Hospital (SIUH) recently agreed to pay a total of $88.9 million to settle allegations that the Hospital was intentionally defrauding the United States through a variety of means. Miguel Tirado, the former head of chemical dependency services at SIUH, brought both a United States and state of New York *qui tam* complaint alleging improper billing of inpatient detoxification treatment. In another complaint, a widow of a former cancer patient treated at SIUH claimed that SIUH knowingly used erroneous billing codes to be reimbursed for non-reimbursable cancer treatments. SIUH was the only hospital providing the specific treatment and as such, was not eligible for reimbursement from Medicare or TRICARE. Rather than using the correct billing codes for this treatment, SIUH allegedly fraudulently used billing codes which would, in fact, receive reimbursement. Elizabeth Ryan, the relator in this case, received $3.8 million as her share of the settlement recovery. Two smaller settlements were borne out of allegations that SIUH purposively overstated its resident count as well as treated psychiatric patients in unlicensed beds. The aggregate result of these four allegations was settlements totaling $88.9 million with whistleblowers shares totaling $9.9 million.

U.S. ex rel. Holbrook v. W.W. Grainger, Inc. (E.D. Wis. July 25, 2008)

W.W. Grainger Inc. paid the United States $6 million to resolve allegations that it defrauded various U.S. government agencies. Grainger, which is based in Illinois and sells industrial equipment and supplies, held a contract with the General Services Administration (GSA). The contract stipulated a fix-percentage mark up of 26% for special goods. The relator, Mr. Brian Holbrook, held the position government sales manager in five states for W.W. Grainger. In this position, Mr. Holbrook allegedly witnessed a mark up of goods higher than the 26%

stipulated in Grainger's contract with the GSA. Additionally, Grainger is legally bound to provide the federal government with high-volume discounts on goods and products which it has allegedly and intentionally failed to do. Lastly, there were allegations that Grainger entered into sales contracts with a number of Asian countries which do not have reciprocal trade agreements with the United States. These actions would thereby violate the Trade Agreement Act. To settle these allegations Grainger has paid the U.S. $6 million, $70,400 of which has been allocated for the relators' share. The investigation was undertaken by the U.S. Attorney's Office for the Eastern District of Wisconsin, the GSA's Office of the Inspector General, and the Justice Department's Civil Division.

Lester E. Cox Medical Centers (W.D. Mo. July 22, 2008)

Lester E. Cox Medical Centers and the United States recently reached a $60 million settlement to resolve allegations of Medicare fraud which violated the Stark Law, Anti-Kickback Statute, and False Claims Act. In addition to a financial settlement, Cox agreed to a Corporate Integrity Agreement in conjunction with the Office of Inspector General of the U.S. Department of Health and Human Services. Specific allegations include entering into a barred financial arrangement with the Ferrell-Duncan Clinic, Inc. physicians group. This financial arrangement presented a situation in which the physicians had financial incentive to refer patients to Cox for treatment. Additionally, there were allegations that Cox defrauded the United States by submitting Medicare cost reports which resulted in Cox's reimbursement for clinic costs that were non-reimbursable. Lastly, it was alleged that Cox fraudulently billed for renal disease treatments through smaller entities controlled by Cox which violated the False Claims Act. The settlement agreement was entered into with attention paid toward the amount of payment that could be made by Cox without compromising their current patient care abilities. That being said, the total settlement agreement was ultimately a cost considerably lower than the alleged monetary amount of fraud. The settlement agreement and allegations were borne out of an investigation which began in 2003 by the Health and Human Services Office of the Inspector General, the Office of Audit Services, and the Federal Bureau of Investigations.

Armor Holdings Products LLC (D.D.C. October 7, 2008)

To resolve allegations that they intentionally and deceptively defrauded the United States, Armor Holdings Products LLC has agreed to pay the United States $30 million. The United States alleged that Armor Holdings manufactured and sold substandard Zylon bullet-proof vests despite its knowledge that Zylon material had rapid degradation qualities. Additionally, the United States alleged that these bullet-proof vests were unsuitable for ballistic use. The

two types of Zylon vests sold by Armor Holdings to the United States had been produced by Tyobo Co. Ltd., who had previously been sued by the United States for similar allegations. Thus, the $30 million settlement is part of a larger, more pervasive investigation into the practice of the body armor manufacturing industry. Three previous settlements total roughly $16 million for similar allegations against Zylon body armor manufacturers. The allegations and ultimate settlement were brought about by an ongoing investigation by the Justice Department's Civil Division, the General Services Administration Office of the Inspector General, the Department of Homeland Security Office of Inspector General, the Defense Criminal Investigative Service, the Air Force Office of Special Investigations, the Department of Energy Office of the Inspector General, the U.S. Agency for International Development Office of the Inspector General, among other agencies.

U.S. ex rel. Klemm v. West Jefferson Medical Center (E.D. La. October 17, 2008)

West Jefferson Medical Center has agreed to pay the United States and the State of Louisiana $3.3 million to settle allegations that the hospital fraudulently billed Medicaid programs. The allegations put forth by the United States suggested that Western Jefferson Medical Center had deceived the Medicaid program into believing that its Pediatric Intensive Care Unit (PICU) could treat patients with specific critical care services, when it realistically could not. This alleged behavior took place between March of 1998 and October of 2003 and resulted in the collection of illegitimate reimbursements by the Medicaid program on the part of Western Jefferson Medical Center. The allegations were initially filed by Leslie Klemm, the relator, who served as a nurse in Western Jefferson. Klemm will receive a total of $627,000 as her share of the settlement between the United States, Louisiana, and West Jefferson. The investigation was led in a cooperative fashion by the Justice Department's Civil Division, HHS-OIG, the Office of the U.S. Attorney in New Orleans and the Louisiana Attorney General's Medicaid Fraud Control Unit.

U.S. ex rel. Bernstein v. Carlson Therapy Network (D. Conn. September 22, 2008)

Carlson Therapy Network has agreed to pay the United States $1.88 million to resolve allegations that it defrauded a number of Government health care programs by intentionally, improperly billing. Government health care programs, such as Medicare and Tricare, require that specific types of physical therapy treatments and services are done in a one-on-one fashion in order to be reimbursed. Rather than properly stating when one-on-one treatment took place, the allegations state that Carlson Therapy Network billed for one-on-one treat-

ments when no such care took place. Instead, Carlson Therapy Network physical therapists overlapped billing time and treated multiple patients at once. The alleged result was United States' losses totaling $943,417 due to pervasive improper billing throughout Carlson's 20 physical therapy facilities. In addition to the financial terms established in the settlement, Carlson Therapy Network has agreed to sign a Corporate Integrity Agreement with the U.S. Department of Health and Human Services in hopes of preventing future Medicare fraud. Leslie Bernstein, the relator and former Carlson Therapy Network employee, will receive $320,762 as her share of the settlement agreement. The settlement was reached as a result of an investigation by the HHS-OIG, Federal Bureau of Investigation, and the U.S. Defense Criminal Investigative Service.

Legal Analysis

Restoring Reason to False Claims Act Motions Practice: The False Claims Act Corrections Act Cuts Through the Turbid Waters of "Public Disclosure" by Placing Responsibility to Move Against "Parasitic" Cases in the Hands of the Justice Department

Restoring Reason to False Claims Act Motions Practice

The False Claims Act Corrections Act Cuts Through the Turbid Waters of "Public Disclosure" by Placing Responsibility to Move Against "Parasitic" Cases in the Hands of the Justice Department

Frederick M. Morgan, Jr.[1] *and Kevin Mitchell Detroy*[2]

This paper, submission of which is adjunct to a panel discussion of motions practice in *qui tam* cases, addresses the reasons why Congress is working to make a particular form of motion—those filed by defendants seeking dismissal for want of federal jurisdiction under the "public disclosure"/"original source" provisions of 31 U.S.C. § 3730(e)(4)—extinct.

INTRODUCTION

The purpose of the 1986 False Claims Act Amendments was to make it easier for *qui tam* relators to bring (and succeed in) False Claims Act cases—and, conversely, to make it harder for contractors who violate the Act to escape liability. Those amendments were necessary, in large part, because courts had done much to interpret the Act to thwart both relators and the United States from succeeding. Congress is now in the process of amending the Act again: History has repeated itself, and amendment is necessary because courts have made a hash of what Congress intended in 1986.

Nowhere (save perhaps the absurdist approach to Rule 9(b) of the Federal Rules of Civil Procedure as a one-size-fits-all means of disposing of any non-intervened case which happens to offend this or that member of the Third Branch) has the need for corrective legislation been more apparent than with respect to the "public disclosure"/"original source" provisions of the Act. Judges have ignored portions of these provisions and tortured others beyond reason. These cases, intermixed with a healthy dose of unclear draftsmanship in the first instance, have created a crazy-quilt of inconsistent standards among the circuits, the majority of which have turned the public-disclosure bar into a far more Draconian provision than Congress intended.

In this paper, we canvass the patchwork public-disclosure/original-source jurisprudence and demonstrate the importance of taking the ability to move for dismissal under that standard away from contractors accused of fraud or false claims and giving it to the Department of Justice, which the False Claims Corrections Act of 2008 will, when passed, accomplish.

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2. Kevin Detroy, also with Morgan Verkamp LLC, graduated *summa cum laude* from Salmon P. Chase College of Law in May 2008. Kevin was Research Editor of the Northern Kentucky Law Review.

BACKGROUND . . . ALL OVER AGAIN

Said the Queen to Alice, "It's a poor sort of memory that only works backward."

Through several iterations of the False Claims Act, Congress grappled with the question of the extent to which the government's knowledge of a contractor's alleged misconduct should impact a relator's right to bring a *qui tam* case. The 1986 Amendments focused on reversal of *United States ex rel. State of Wisconsin v. Dean,* where the court refused to allow the State of Wisconsin to act as a *qui tam* relator in a Medicaid fraud action—even though the investigation had been conducted solely by the state—because it had sent information about the fraud to the government.[3] That holding resulted from what came to be called the "government knowledge" bar in the 1943 amendments to the False Claims Act: the provision that the relator can proceed when the government declines intervention, unless "it shall be made to appear that such suit was based upon evidence or information in the possession of the United States, or any agency, officer or employee thereof, at the time such suit was brought." This provision, former 31 U.S.C. § 232(c), was largely responsible for the near-abandonment of the Act prior to 1986.[4]

The 1986 Amendments provide that "[n]o court shall have jurisdiction over an action under this section based upon the public disclosure [in narrowly-defined ways] of allegations or transactions . . . unless the . . . person bringing the action is an original source of the information."[5] An "original source" is "an individual who has direct and independent knowledge of the information on which the allegations are based[.]"[6]

Congress thus incorporated the concept that where there has been a public disclosure, a relator must be an "original source" of the information, which had been in the 1943 Senate bill but was not included in the bill which emerged from conference committee, and introduced the concept of "public disclosure." Congress' purpose was to guard against the government's concern regarding "parasitic" suits initiated by "opportunists" by ensuring that once there had been a public disclosure, only someone with knowledge of the false claims obtained from a source other than the public disclosure could be a *qui tam* relator.[7]

3. 729 F.2d 1100, 1106–07 (7th Cir. 1984).

4. *See generally* United States ex rel. Doe v. John Doe Corp., 960 F.2d 318, 321 (2d Cir. 1992) (noting that FCA qui tam actions under the "government knowledge" bar went from "unrestrained profiteering to a flaccid enforcement tool.").

Other factors included judicially legislated elevation of the burden of proof and *scienter* standards. These issues are discussed in detail in the Senate Judiciary Committee's report accompanying the 1986 Amendments, S. Rep. No. 99-345, *as reprinted in* 1986 U.S.C.C.A.N. 5266.

5. 31 U.S.C. § 3730(e)(4)(A).

6. Id. § 3730(e)(4)(B).

7. We discuss below and in more detail that many courts construing the public disclosure bar have focused preternaturally on Congress's purported fear of so called "parasitic" lawsuits, thus blinded to the overarching and dominant purpose of the FCA generally and the 1986 Amendments specifically—to encourage those with knowledge of fraud on the government to come forward. *E.g.*, United States ex rel. McKenzie v. BellSouth Telecommunications, Inc., 123 F.3d 935, 940 (6th Cir. 1997) ("The jurisdictional requirements are designed to restrict the number of persons who can bring *qui tam* actions and thereby avoid parasitic suits").

Perhaps it is unsurprising, given the phenomenal aggregation of political power which the largest government contractors and their industries (defense, paramilitary, hospital, medical, and pharmaceutical come to mind) have at their disposal, that judicial interpretations of these provisions have resulted in a landscape dramatically different and far more hostile to the recovery of funds cheated from the taxpayers than what Congress intended in 1986. Moreover, there are many inter-circuit conflicts regarding several substantive points, the result being that a case which might proceed to judgment in one circuit is found "jurisdictionally" barred in another.[8]

The drafters of the 1986 Amendments began "publicly disclosing" their concern with bogus court decisions in this area almost a decade ago, when Congressman Howard Berman and Senator Charles Grassley wrote a lengthy letter to the Department of Justice flagging the problem.[9] The letter, which was sent to then-Attorney General Janet Reno, said in part:

> With dismay . . . we have watched the federal courts interpret several sections of the Amendments in ways that directly contravene Congressional intent, and, of even greater significance, discourage and foreclose potential relators from bringing meritorious cases. In particular, we are extremely concerned with the courts' crabbed interpretations of the public disclosure bar—Sec. 3730(e)(4)(A) and (B). That provision, which was drafted to deter so-called "parasitic" cases, has been converted by several circuit courts into a powerful sword by which defendants are able to defeat worthy relators and their claims. If this trend continues, we fear that the very purpose of the Amendments—"to encourage more private enforcement suits"—ultimately will be undermined.
>
> Thus, we believe it is imperative that the Department of Justice ("the Department") adopt and adhere publicly to an interpretation of the public disclosure bar that comports with the plain meaning of the statute and the Congress' obvious intent. The Department's role in this regard is critical. First, of course, the Department is often involved as a party in cases where the public disclosure bar is raised, and it is entitled and expected to make its views known. Even in cases where the Department

8. The meaning of the word "jurisdiction" in the public disclosure provision was the subject of some judicial debate. The district court in *United States ex rel. Yannacopolous v. General Dynamics*, 315 F. Supp. 2d 939, 951 (N.D. Ill. 2004) held, "[s]ections 3730(e)(4)(A) & (B) are matters of substantive law, not a 'jurisdictional bar' as suggested by some courts." (citing *United States ex rel. Feingold v. AdminaStar Fed., Inc.*, 324 F.3d 492, 494–95 (7th Cir. 2003)). And in *United States ex rel. Fallon v. Accudyne Corp.*, 97 F.3d 937, 940–941 (7th Cir. 1996), Judge Easterbrook, considering this issue, referred to the word "jurisdiction" as a "notoriously plastic term." However, this debate was put to bed in *Rockwell Int'l Corp. v. United States ex rel. Stone*, 127 S. Ct. 1397 (2007), where the Court sternly rejected *Fallon* and underscored the point by stating that the statute is *ex visceribus verborum*, perhaps in the belief that if lawyers must look up a phrase the point will be better-retained.

9. 145 Cong. Rec. E1546 (July 14, 1999).

> determines not to intervene, Congress intended for the Department to be involved in monitoring cases, in part to address questions significant to the ongoing operation of the statute. Finally, as the agency charged, in effect, with the administration of the False Claims Act, the courts are likely to accord significant deference to the Department's interpretation of the Act, and we believe the Department has an obligation to the Congress and to the courts to articulate those views.[10]

The Department elected not to accept Congressman Berman and Senator Grassley's invitation to join in the effort to derail the judicially legislated aberrant interpretations of the "public disclosure" provision, choosing instead to rely, when it did take positions, on the incorrect interpretations of "based upon" and the judicial third prongs discussed below.[11] Indeed, in briefing these issues before the Supreme Court, the Solicitor General made little effort to argue against the majority—and wrong—interpretation of "based upon" discussed below.[12]

THE CORRECTIONS ACT CHANGES COURSE

Bipartisan bills introduced in the House (H.R. 4854) and Senate (S. 2041) as the False Claims Act Corrections Act of 2008 propose a different approach to the "parasitic relator" problem. Under these bills, the United States, rather than the defendant in a False Claims Act case, would be the proper party to seek dismissal of a case on public disclosure grounds. This change makes sense for several reasons. Most importantly, the party which actually owns *qui tam* claims—the United States—will be the decision-maker regarding whether to suggest that a case is based on information in the public domain (or, under some proposals, otherwise known to the government). Second, the government can be predicted to take consistent litigation positions nationwide. Third, the government will be able to make better-reasoned intervention decisions, knowing that declined cases with strong facts and substantial damages will not be dismissed on jurisdictional grounds. Fourth, a time-consuming preliminary round of litigation will be eliminated, permitting litigants and courts to focus more quickly on the merits. Fifth, the understandable propensity of defendants to push the prudential envelope (which is, after all, the driving force behind the mishmash which the public-disclosure provision has become) will be eliminated.

10. Id. (internal citations omitted).

11. Most notably, in United States ex rel. Rost v. Pfizer, No. 06-2627 (First Cir., Brief Filed April 2007), the Justice Department not only adopted the indefensible majority view of the "based upon" language of the public disclosure provision, but pushed for adoption of the Sixth Circuit's third-prong analysis, which had never previously considered by the First Circuit. The Department's brief is available online at http://www.taf.org/opinions/Rost/DoJCircuitCourtAmicus.pdf.

12. Brief of Respondent United States in Rockwell Int'l Corp. v. United States of America, No. 05-1272 (United States Supreme Court, November 2006) at 12 n.4, 39–41, *available at* http://www.taf.org/SG-Rockwell.pdf.

SOME OF THE MISINTERPRETATIONS THE CORRECTIONS ACT WILL REMEDY

A. "Based Upon" Whole Cloth

Said the Dormouse, "You might just as well say that 'I breathe when I sleep' is the same thing as 'I sleep when I breathe'!"

The most ubiquitous misinterpretation of the public-disclosure bar is also the most destructive of Congress's desire to encourage persons knowledgeable of false claims against the taxpayers to come forward. It arises from the requirement in the 1986 Amendments that *only* cases "based upon" the public disclosure would be barred.[13] The Fourth Circuit correctly held that in using those words, Congress intended to bar cases "actually derived from" the public disclosure.[14]

However, a majority of circuits have disregarded the plain meaning of the phrase "based upon," and held that "based upon" meant "supported by."[15] Under these cases, it does not matter whether the *qui tam* plaintiff has inside, direct knowledge; if her allegations are the same as or similar to what was contained in the public disclosure, then the district court is deprived of jurisdiction. These counter-textual holdings have resulted in the dismissal of countless cases brought by *qui tam* plaintiffs who had detailed insider knowledge of False Claims Act violations.[16]

13. As discussed more fully *infra*, the phrase "public disclosure" has also been misinterpreted. One of the most inappropriate interpretations came from the same Seventh Circuit opinion, United States ex rel. Mathews v. Bank of Farmington, 166 F.3d 853 (7th Cir. 1999), which adopted the erroneous view that the public disclosure bar is concerned with disclosure to the government rather than "parasite" relators. Ironically, the *Matthews* Court offered the most commonsense construction of the "based upon" terminology. See supra, note 42.

14. United States ex rel. Siller v. Becton Dickinson & Co., 21 F.3d 1339, 1347–48 (4th Cir. 1994), *cert. denied,* 513 U.S. 928 (1995). Perhaps the most reasonable construction of "based upon" was adopted by the Seventh Circuit. *Mathews,* 166 F.3d at 863. However, the court's determination that information contained in a loan application submitted by a defendant to a bank was "publicly disclosed" is so far from the plain language of the False Claims Act that the decision, on balance, fails to interpret the Act as written.

15. *E.g.,* United States ex rel. Precision Co. v. Koch Indus., 971 F.2d 548, 552 (10th Cir. 1992), *cert. denied,* 507 U.S. 951 (1993); *accord* United States ex rel. Doe v. John Doe Corp., 960 F.2d 318, 324 (2d Cir. 1992); United States ex rel. Kreindler & Kreindler v. United Tech. Corp., 985 F.2d 1148, 1158 (2d Cir. 1993); United States ex rel. Springfield Terminal Ry. Co. v. Quinn, 14 F.3d 645, 652–55 (D.C. Cir. 1994); *McKenzie,* 123 F.3d at 940; United States ex rel. Wang v. FMC Corp., 975 F.2d 1412, 1417 (9th Cir. 1992); United States ex rel. Cooper v. Blue Cross and Blue Shield of Fla., Inc., 19 F.3d 562, 566–67 (11th Cir. 1994)); *see also* United States ex rel. Paranich v. Sorgnard, 396 F.3d 326, 334-35 (3d Cir. 2005); Fed. Recovery Servs. v. United States, 72 F.3d 447, 451 (5th Cir. 1995); United States ex rel. Minn. Assoc. of Nurse Anesthetists v. Allina Health Sys. Corp., 276 F.3d 1032, 1044–47 (8th Cir. 2002).

16. Persuasive discussion of the linguistic absurdity of the majority position appears in United States ex rel. Rost v. Pfizer, Inc., 446 F. Supp. 2d 6, 19–20 (D. Mass. 2006), *aff'd and remanded,* 507 F.3d 720 (1st Cir. 2007). The variety of justifications which judges have advanced for these holdings is tribute to their creativity, and perhaps that of their clerks. It is beyond our scope in these pages to go through them, except to note that, in the main, they have acknowledged that they are ignoring the plain meanings of the words Congress chose, and substituting an entirely different meaning in order to achieve a desired result.

B. "Third Prongs" Stick it to *Qui Tam* Relators

Says Alice, "At least I know who I was when I got up this morning, but I think I must have been changed several times since then."

A second strain of holdings just as inconsistent with the purposes behind the 1986 Amendments came in the form of decisions adding all-but-random additional elements to the statutory definition of "original source." The first such "third prong" came in *United States ex rel. Dick v. Long Island Lighting Co.*, where the court held that in order to be an original source, the *qui tam* plaintiff must have "directly or indirectly" disclosed the information to "the entity that publicly disclosed the allegations."[17] The Ninth Circuit subsequently adopted the same standard.[18] Other circuits rejected these holdings, but engrafted another additional requirement—that the *qui tam* plaintiff disclosed the information on which the suit was based to the government before the public disclosure occurred.[19]

The continuing validity of these "third prong" original source decisions has been placed in doubt by *Rockwell*; however, the extent of *Rockwell*'s influence in this area must await future adjudication. In *Rockwell*, the Supreme Court held that the term "information" was a reference to the same thing in both § 3730(e)(4)(A) and (B)—namely, the information upon which the relator's allegations are based.[20] This conclusion is clearly at odds with the holding in *Dick*, suggesting that the latter has been effectively abrogated. The fate of *Wang* and the other cases is less certain because, unlike *Dick*, none of them relied upon a now-defunct textual analysis. It is nonetheless notable that the Court's opinion does not reference any of the third-prong cases.

Federal subject-matter jurisdiction over *qui tam* cases varies from court to court depending on which concatenation of judicial interpretations of the public-disclosure bar has been adopted. *Qui tam* relators and their counsel are left to divine how a particular court may interpret its jurisdiction on a given day. And as this article was in final preparation, the editorial pages of the *Wall Street Journal* published a screed against the Corrections Act accusing its sponsors of pandering to "trial lawyers" overreacting to "courts [which] have modestly reined [the act] in over the years."[21] That the impossibly-powerful community of False Claims Act targets and their apologists are willing to carry to ostensibly-responsible journalists the calumny that "trial lawyers" are pushing an overreac-

17. United States ex rel. Dick v. Long Island Lighting Co., 912 F.2d 13, 16 (2d Cir. 1990).

18. *Wang*, 975 F.2d at 1419 (9th Cir. 1992). Interestingly, the *Wang* Court was not as eager as the Dick Court to assert that the plain language of § 3730(e)(4)(A) and (B) is all too clear, noting that "undoubtedly the text remains ambiguous." Id. at 1418. Frustrated with the language, the *Wang* Court relied instead upon its view of the purposes of the FCA and the 1986 Amendments; namely, "that *qui tam* jurisdiction was meant to extend only to those who played a part in publicly disclosing the allegations and information on which their suits were based." Id.

19. United States ex rel. Findley v. FPC-Boron Employees' Club, 105 F.3d 675, 690–91 (D.C. Cir. 1997), *cert. denied*, 118 S. Ct. 172 (1997); *McKenzie*, F.3d at 938.

20. *Rockwell*, 127 S. Ct. at 1408.

21. *False Claims Gold Rush*, Wall Street Journal, May 2, 2008, at A14.

tion to "modest" judicial "reining in" is ample evidence of the need for clear and firm congressional guidance.

C. Me, Myself and I: FOIA Foolishness

Said the Cheshire Cat: "If you don't know where you are going, any road will take you there."

Were the foregoing not of itself sufficient to force an unwholesome level of unpredictability to those attempting to make reasoned judgments about what cases to bring and where to bring them, the situation has become even more confused in recent years due to judicial bending-over-backward to find "public disclosure" where none existed. There is particular irony in a strain of decisions holding that a *qui tam* relator who dares to investigate her case by serving a Freedom of Information Act request on a government agency actually *defeats jurisdiction* when and if the government responds. Remarkably, moreover, several circuits have held that a would-be whistleblower causes a public disclosure by requesting information pursuant to the Freedom of Information Act.

The first court to reach this bizarre conclusion was *United States ex rel. Burns v. A.D. Roe Co.*[22] Relying on an obvious misreading of *United States ex rel. Schumer v. Hughes Aircraft Co.*,[23] *Burns* vaguely held that the contents of FOIA responses are publicly disclosed once received by the requesting party.[24]

The most seemingly thoughtful FOIA-response-as-public-disclosure case is *United States ex rel. Mistick PBT v. Housing Authority of City of Pittsburgh*.[25] In *Mistick*, the court looked to the text of the Freedom of Information Act itself, which makes repeated reference to "the public," as well as an opinion in which the Supreme Court held that a FOIA response by the Consumer Product Safety Commission constituted a "public disclosure."[26]

Other courts have disagreed. In *United States ex rel. Haight v. Catholic Healthcare West*, the court considered the effect of a FOIA request by a relator on the jurisdictional bar.[27] As part of her investigation of false statements related

22. 186 F.3d 717 (6th Cir. 1999).

23. 63 F.3d 1512, 1519-20 (9th Cir. 1995), *vacated on other grounds*, 520 U.S. 939 (1997).

24. *Burns*, 186 F.3d at 723–24.

25. 186 F.3d 376 (3d Cir. 1999) (Alito, J).

26. Id. at 383.

The 1999 letter from the House and Senate sponsors of the 1986 Amendments to Attorney General Reno, discussed earlier, came shortly after the Sixth and Third Circuits mistook FOIA requests for public disclosures and sharply criticized those holdings. 145 Cong. Rec. E1546-01 (1999) (statement of Rep. Howard Berman and Sen. Charles Grassley, the principal House and Senate sponsors of the 1986 Amendments, that they do not view FOIA requests as public disclosures). The letter stated:

> We want forcefully to disagree with cases holding that qui tam suits are barred if the relator obtains some, or even all, of the information necessary to prove fraud from publicly available documents, such as those obtained through a Freedom of Information Act (FOIA) request. . . . We believe that a relator who uses their education, training, experience, or talent to uncover a fraudulent scheme from publicly available documents, should be allowed to file a *qui tam* action. . . . This is especially true where a relator must piece together facts exposing a fraud from separate documents.

27. United States ex rel. Haight v. Catholic Healthcare West, 445 F.3d 1147, 1152–53 (9th Cir. 2006).

to a grant application submitted to the National Institutes of Health ("NIH"), Haight sought documents from NIH through a FOIA request.[28] Included in the documents received pursuant to the FOIA request was the grant application itself which, according to *Haight*, contained the false statements upon which her subsequent *qui tam* claim was based.[29] The United States declined to intervene, and the complaint was unsealed and served upon the defendants.[30] After some discovery, the defendants filed a motion to dismiss the suit for lack of jurisdiction based upon the theory that NIH's response to Haight's FOIA request was a public disclosure.[31] The district court agreed, citing *Schumer* for the proposition that FOIA requests constitute public disclosure.[32]

The Ninth Circuit reversed. "*Schumer* holds only that material in a government file that is potentially accessible to the public through a FOIA request is *not* publicly disclosed."[33] The court similarly rejected the defendant's urgings to adopt the reasoning of *Mistick:* because the terms "report" and "investigation" denote "governmental legwork" as opposed to responding to a FOIA request which entails "little more than duplication," "Interpreting 'report' or 'investigation' as listed in the jurisdictional bar to include any document obtained in response to a FOIA request would stretch the meaning of those terms too broadly."[34]

Haight correctly recognized that viewing a FOIA response as a public disclosure would "deter individuals who suspect fraud from investigating it," as "FOIA requests are one of the simplest vehicles by which interested citizens can uncover possible fraud against the government."[35]

Haight's conclusion was followed in *United States v. Solinger.*[36] In order to reach this result, the district court had to work around the Sixth Circuit's decision in *Burns,* which it did by interpreting the Circuit's decision as requiring that the FOIA-produced document itself satisfy the statutory definition of "public disclosure."

The district court in *United States v. Yannacopolous v. General Dynamics*[37] reached the same result, recognizing that treating FOIA responses as public disclosures would destroy the incentive for citizen-led investigations encouraged by the 1986 Amendments. The court posited that if documents produced to a single requester pursuant to a FOIA request were to trigger the jurisdictional bar, then

28. Id. at 1149.

29. Id.

30. Id. at 1150.

31. Id. at 1151.

32. *Haight*, 445 F.3d at 1153 n.2.

33. Id. (emphasis added).

34. Id. at 1153.

35. Id. at 1155 n.5.

36. 457 F. Supp. 2d 743, 751 (W.D. Ky. 2006).

37. 315 F. Supp. 2d 939, 951 (N.D. Ill. 2004).

> every corporation would be well-advised to request as much FOIA material as possible. If the corporation was later named a defendant in a FCA action, then anything in the FOIA request would be a public disclosure merely because the defendant asked for it in a FOIA request. Certainly, the FCA was not intended to insulate corporations in this manner.[38]

Two other courts have held that FOIA responses are not public disclosures. The Fourth Circuit reached the painfully-obvious conclusion that FOIA is not a public disclosure because Section 3730(e)(4)(A) does not list FOIA responses as a means of disclosure.[39] In *United States ex rel. Pentagen Technologies Int'l Ltd. v. CACI Int'l Inc.*, the court similarly held that FOIA responses do not trigger the public disclosure bar because—why is this so hard?—there is no public disclosure.[40]

D. The Sharpest Cut?

The Black Knight: "It's just a flesh wound! Come back and I'll bite your kneecaps off."

Congress thought, in 1986, that it was incentivizing knowledgeable informants to retain capable counsel, and that teams thus constituted would contribute resources to the fight against rapacious government contractors.

In yet another departure from what was intended by Congress in 1986, at least two recent decisions have held that a relator litigating a declined case cannot use information obtained in assisting the government's investigation. In *United States ex rel. Fowler v. Caremark Rx, LLC,* the court held that a defendant's response to a subpoena resulting from a *qui tam* relator's allegations by providing documents to the United States Attorney constituted a "public disclosure."[41] When the relator filed an amended complaint which included some of that information, the court held that it lost jurisdiction because the amended complaint was based upon the "public disclosure" of information to the government.

The *Fowler* panel concluded that the public disclosure bar is triggered when allegations are revealed to the government from one other than the relator herself. "'The point of the public disclosure of a false claim against the government is to bring it to the attention of the authorities, not merely to educate and enlighten the public about the dangers of misappropriation of their tax money.'"[42]

Fowler's reasoning runs counter to the legislative history of the 1986 Amendments and fails to acknowledge role of *qui tam* relators under the FCA. While the 1986 Amendments were enacted to reinvigorate the FCA by encouraging re-

38. Id.

39. United States ex rel. Bondy v. Consumer Health Foundation, 28 F. App'x. 178, 181 n.2 (4th Cir. 2001) (unpublished).

40. No. 94 CIV. 2925, at *9 (S.D.N.Y. Nov. 22, 1995).

41. 496 F.3d 730, 736 (7th Cir. 2007), *cert. denied,* 128 S. Ct. 1246 (2008).

42. Id. at 736 (quoting *Matthews*, 166 F.3d at 861).

lators to come forward, the jurisdictional bar specifically was inserted to prevent so-called "parasitic" plaintiffs—those who cut and paste fraud allegations drawn from public sources. This is hardly an appropriate description of one who, having personal knowledge of fraudulent behavior, works hand-in-hand with the government to unearth the depth of the wrongdoing. Such an individual who "sounds the alarm" to the government of potential fraud is the impetus for the investigation. What is clear from the history is that it was disclosure of fraud to the public—not to federal prosecutors—that Congress was concerned about.

Moreover, the *qui tam* provisions of the FCA were born out of the recognition that federal enforcement authorities lack the resources not only to discover all frauds against the government, but also to prosecute them. The United States chooses not to intervene in the majority of *qui tam* complaints. While it is doubtless true that many declinations are based on government counsel's view of the merits, it is our experience that resource issues often loom large in terms of both the government's ability fully to investigate claims during the seal period, and the appropriate reluctance of government counsel to commit to litigating more cases than can be handled. This was underscored during the late 1970s and early 1980s when fraud against the government exploded. That the government may be aware of a particular fraudulent scheme by one of its contractors does not necessarily mean that enforcement action will be taken, and in fact very likely will not. Congress did not craft the original-source provision to bar from the courtroom the very people it hoped would assist overburdened federal prosecutors simply because those same prosecutors may already know of the fraud but lack the resources to do anything about it.

The First Circuit recently rejected the amalgamated contractor lobby's efforts to use a *Fowler*-like argument to fully reinvigorate the "government knowledge" bar abandoned by Congress in 1986. In *United States ex rel. Rost v. Pfizer, Inc*,[43] Pfizer, joined by the National Defense Industrial Association, the Pharmaceutical Research and Manufacturers of America, and the American Hospital Association, argued that self-disclosure by a defendant to the government—without more—constituted a public disclosure under 31 U.S.C. § 3730(e)(4)(A). The court did not take Pfizer's bait, noting prosaically that the "[g]overnment may be of the people, by the people, and for the people, but that does not mean the government and the public are the same."[44]

In *United States ex rel. Montgomery v. St. Edwards Mercy Medical Center*,[45] the court held with scant analysis that when a relator learns relevant facts from the United States during the course of its investigation of a filed *qui tam* case, the government's communications to the relator constitute a "public disclosure" and the court lacks jurisdiction over an amendment including that information.

That a company's providing documents to the United States Attorney while allegations in a *qui tam* case are being investigated could be a "public disclo-

43. 507 F.3d 720 (1st Cir. 2007).

44. Id. at 729.

45. No. 4:05-CV-899, at *16 (E.D. Ark. Sept. 28, 2007) (Mem. Op. and Order, Doc. 76)

sure" misapprehends Congress's fundamental concern: preclusion of cases based on information in the public domain. Documents provided to the government during investigation of a sealed complaint do not qualify. Moreover, a central purpose of the 1986 Amendments was to encourage and empower relators and their representatives to provide resources to assist the government in its investigation. Consistent with this purpose, courts have recognized that during the pendency of a *qui tam* case, communications between the government and the relator are privileged.[46]

Dismissing a complaint because it incorporates information learned during a relator's efforts on the government's behalf improperly penalizes the relator for doing what Congress intended and skews the effective operation of the Act. Holdings like these are inconsistent with the balance Congress sought to establish in 1986 and demonstrate further why the Committee has chosen to put the decision to seek dismissal related to publicly disclosed information in the hands of the United States.

CONCLUSION

Judicial interpretations of the public disclosure and original source provisions of the False Claims Act Amendments Act have strayed dramatically from what Congress intended in 1986. Congress therefore is prepared to eliminate those provisions in favor of empowering the Department of Justice to seek dismissal of cases where the government is already involved in an investigation of the potential violations of the False Claims Act alleged by the *qui tam* plaintiff. The policy considerations at issue are uniquely the province of the government and the Justice Department. Experiences since 1986 have demonstrated that when it is left to the accused contractor to assert that a *qui tam* plaintiff is not properly advancing the federal interest, parochial interests lead to skewed results. That three versions of the statute spread over 80 years have not gotten quite right the balance between information in the public domain and the appropriate service of *qui tam* plaintiffs demonstrates that what to do with cases relating to disclosed information is a work in progress. That two decades of litigation since the 1986 Amendments have resulted in a confused and unpredictable landscape demonstrates that progress will be impossible without change. It is not without trepidation that we look forward to a new era where the Department of Justice, rather than the world's largest corporations and law firms, are responsible for initiation of motions practice designed to address parasitic *qui tam* cases. However, the "devil we know" has proven so willing to advance with glee arguments which are wildly inconsistent with Congress's intent that change is essential. Perhaps this time the courts will not put it asunder.

46. *E.g.*, United States ex rel. Miller v. Harbert, Civil Action No. 95-1231, at *3 (D.D.C. Feb. 2, 2007) (Mem. Op., Doc. 530) (common interest privilege applies to communications between FCA relator and United States because each "had a common interest in the prosecution of common defendants in an existing civil or criminal case or both.").

Spotlight

Whistleblowers and *Qui Tam* for Tax

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Whistleblowers and *Qui Tam* for Tax

*Dennis J. Ventry, Jr.**

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I. INTRODUCTION

In 1998, as Congress listened to sensational testimony of abuse and coercion by Service agents—nearly all of which turned out to be false or grossly exaggerated[1]—Senator Harry Reid (D-NV) was fuming mad. In addition to encouraging its revenue agents to engage in intimidation tactics, the Service was enlisting taxpayers in overzealous collections efforts by rewarding them for retaliating

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1. *See* Leandra L. Lederman, *Of Taxpayer Rights, Wrongs, and a Proposed Remedy*, 87 Tax Notes (TA) 1133, 1135-36 (May 19, 2000) (describing unsubstantiated and false anecdotes of Service "horror stories" relayed by witnesses at the 1998 Service oversight hearings); *GAO Report on Allegations of IRS Taxpayer Abuse, Special Report, Tax Administration: Investigation of Allegations of Taxpayer Abuse and Employee Misconduct Raised at Senate Finance Committee's IRS Oversight Hearings*, 2000 Tax Notes Today 80-13 (May 24, 1999) (finding "no evidence that IRS employees had acted improperly" as alleged by hearing witnesses).

against alleged tax cheats. Referring to an informant program that he dubbed the "Reward for Rats Program," Reid told Congress that the Service was paying "snitches to act against associates, employers, relatives, and others—whether motivated by greed or revenge—in order to collect taxes."[2] Reid found the program "unseemly, distasteful, and just wrong," as well as "a powerful incentive to anyone interested in becoming rich at the expense of a neighbor, former business associate, former wife, former husband."[3] Reid urged his colleagues to abolish the program.

Nine years later, in May 2007, Senator Charles Grassley (R-IA) spoke of the same program that had infuriated Reid. Rather than refer to Service informants as "rats," however, Grassley praised their "courage and patriotism."[4] These individuals, Grassley said, "often risk their careers to expose fraud, waste, and abuse in an effort to protect not only the health and safety of the American people, but the federal treasury and taxpayer dollars."[5] Grassley was speaking of all federal whistleblowers in a speech kicking off "National Whistleblower Week." But he likely was thinking in particular of tax whistleblowers, given that he had championed legislation in 2004[6] for the creation of a Service Whistleblower Office and that his staff wrote the provision in the Tax Relief and Health Care Act of 2006[7] that authorized such an office, greatly enhancing the Service's whistleblower program.[8]

This Article examines the expanded tax informant program and the recently established Whistleblower Office. It largely embraces the revamped tax whistleblower provisions, and recommends that Congress broaden the program still further to allow private citizens to bring *qui tam* lawsuits against taxpayers for violations of the internal revenue laws.[9] Other federal and state whistleblower statutes, including the wildly successful False Claims Act (FCA),[10] already provide for *qui tam* actions against persons submitting false claims to the government.[11] The FCA, like the tax whistleblower statute, rewards private individuals

2. *Internal Revenue Service Restructuring and Reform Act of 1998*, 144 Cong. Rec. S4379-05, 4397–98 (daily ed. May 6, 1998) (statement of Sen. Reid).

3. *Id.* at 4398.

4. *Floor Statement of Senator Chuck Grassley: National Whistleblower Week*, [May 14, 2007], 7 TaxCore 93 (BNA) (May 15, 2007).

5. *Id.*

6. *See* S. 1637, 108th Cong. § 488 (2004).

7. Pub. L. No. 109-432, § 406, 120 Stat. 2911, 2958–60 (2006).

8. Dustin Stamper, *Whitlock Tapped to Head New IRS Whistle-blower Office*, 114 Tax Notes (TA) 628 (Feb. 12, 2007) (describing the role of Grassley's staff in drafting the provision).

9. "*Qui tam*" is shorthand for "*qui tam pro domino rege quam pro se ipse*" or "he who sues for the king as for himself."

10. 31 U.S.C. §§ 3729–3733 (2000).

11. As of October 1, 2007, sixteen states (California, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Mexico, New York, Oklahoma, and Virginia) and the District of Columbia had enacted false claims statutes containing *qui tam* provisions. Three additional states (Louisiana, Tennessee, and Texas) had *qui tam* laws that applied to heath care fraud, while two municipalities, Chicago and New York City, had enacted false claims ordinances with *qui tam* enforcement mechanisms. *See* http://www.taf.org/statefca.htm.; *see also* John T. Boese, Civil False Claims and *Qui Tam* Actions §§ 6.01, 6.02 &

for exposing others' attempts to cheat the government. But unlike the tax statute, the FCA authorizes private individuals to sue on the government's behalf in the form of *qui tam* actions. This Article proposes using the FCA as a model for the tax whistleblower statute, and extending *qui tam* to tax.

The experience of the FCA suggests that private enforcement of public law[12] can be a particularly powerful monitoring and prosecutorial mechanism in areas of law where government officials—due to asymmetric information, active concealment by regulated parties, and weak enforcement—are unable or unwilling to enforce the law or prosecute offenders effectively. Current tax regulation suffers from all three symptoms, and could benefit from private enforcement efforts. The 2006 amendments to the tax whistleblower statute significantly expand the potential size of rewards paid to informants, and thereby heighten the threat that an insider might expose abusive taxpayer behavior. In this way, the enhanced tax whistleblower statute has added risk of detection and prosecution to the compliance calculus. Extending *qui tam* to tax would add an additional element of risk to tax cheating and noncompliance, and further assist the government in enforcing tax laws.

Part II of this Article provides a brief history of the tax whistleblower law, and describes the 2006 amendments. Part III explains why Congress expanded the tax whistleblower statute, including legislators' explicit hopes that an enhanced tax informant program would assist in the collection of evaded tax liabilities, close the "tax gap,"[13] and improve tax compliance. Part IV describes the design, implementation, and success of the False Claims Act. Part V articulates the argument for bringing *qui tam* to tax. It demonstrates the multiple benefits of private enforcement of the nation's tax laws, including (1) assisting tax officials in overcoming information deficits and aggressive concealment on the part of taxpayers; (2) adding risk to abusive taxpayer behavior by increasing the probability of detection and prosecution of tax violations; (3) closing the "resource gap" currently separating tax regulators and private sector tax lawyers; (4) aligning the interests of taxpayers and tax regulators by providing economic incentives for private persons to expose alleged tax violations; and (5) altering governance and compliance norms within business organizations, thus deterring noncompliant behavior at the source. Part VI addresses potential concerns respecting an expanded tax whistleblower program, including taxpayer privacy, frivolous and harassing claims, and inadequate protections for whistleblowers.

Finally, Part VII examines in detail perceived threats to professional confidentiality created by the new whistleblower statute. Recent legislative and administrative changes—particularly requirements under the Sarbanes-Oxley

6.05 (3d ed. 2007).

12. "Public law" encompasses laws governing the relationship between individuals and the state (such as tax, securities, and constitutional law) and is often juxtaposed against "private law," encompassing laws governing the relationship between individuals and other individuals (such as contract and tort law).

13. The "tax gap" is defined as the difference between the tax that taxpayers should pay and what they pay on a timely basis. For further discussion of the tax gap and Congress's response to it, see *infra* notes 50–53 and accompanying text.

Act of 2002, amendments to regulations governing tax practice in 2005, and legislative and jurisprudential trends extending whistleblower protections—impose heightened obligations on lawyers and other professionals to monitor and enforce public policies underlying public laws. Thus, in an increasing number of situations, these advisors already have a duty under federal law to disclose confidential information. Both the enhanced tax whistleblower statute and the recommendation to extend *qui tam* to tax buttress those public policy obligations for lawyers, and impose similar duties on non-lawyers to help enforce the nation's tax laws.

II. WHAT'S NEW?

As early as 1867, the federal government had at its disposal a law allowing it to pay individuals supplying information for "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same."[14] The original statute authorized $100,000, "or so much thereof as may be necessary,"[15] to finance the informant program, a phenomenally high figure given a federal budget that only a few years earlier barely exceeded $60 million.[16] The statute authorizing the informant program remained separate from the revenue acts until Congress enacted section 3792 of the Revenue Act of 1934, providing expenses for the "detection and punishment of frauds" related to the internal revenue laws.[17] In 1954, the statute was recodified as section 7623, where it remained largely unchanged, underutilized, and unknown until last year.[18]

The 2006 amendments[19] to section 7623 breathed life into the statute. First, the enabling legislation authorized the Service to create a centralized Whistleblower Office[20] that will process tips received from individuals who "spot tax problems in their workplace, while conducting day-to-day personal business, or

14. As enacted: Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified by ch. 11, § 3463, 35 Rev. Stat. 686 (1873–74)). The tax informant statute followed closely on the heels of the original federal False Claims Act, enacted "to prevent and punish Frauds upon the Government of the United States." Congress enacted the earlier statute, originally known as the "Informants' Act" or "Lincoln's Law," to address allegations of fraud, defective weaponry, and illegal price-fixing of the Union Army during the Civil War. The False Claims Act was codified as the Act of Mar. 2, 1863, ch. 67, 12 Stat. 696, 696–98 (reenacted by §§ 3490–3494, 36 Rev. Stat. 691–92 and ch. 5, § 5438, 70 Rev. Stat. 1054–55 (1878)).

15. Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. at 473.

16. *See* http://encarta.msn.com/encyclopedia_761567354_18/Civil_War.html.

17. Revenue Act of 1934, ch. 3792, 48 Stat. 680.

18. *See* I.R.C. § 7623 (1954). Prior to the 2006 amendments to section 7623, the only material change after 1954 involved the 1996 amendments, which included for the first time "detecting underpayments of tax" as a criterion for awarding payments to informants, adding to the existing "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same." Detecting Underpayments of Tax, Pub. L. No. 104-168, § 1209(a), 110 Stat. 1452 (2006).

19. *See* Awards to Whistleblowers, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006) (adding subsection (b)).

20. I.R.C. § 406(b). The enabling legislation also required Treasury to issue guidance respecting the operation of the Whistleblower Office by December 20, 2007, which it did in Notice 2008-4.

anywhere else they may be encountered."[21] The new office will also determine whether to investigate the matter itself or assign it to another Service office, and it will monitor actions taken by the Service with respect to informant information. In addition, it will determine whether and how much to pay informants, a responsibility previously delegated to Service District Directors dispersed throughout the country. The new office opened for business in February 2007, with the former head of the Service Office of Professional Responsibility, Stephen Whitlock, taking over as its first Director.[22] Early indications are that the revamped whistleblower program is working as planned, with "knowledgeable insiders" turning over "big, fat piles of paper" some involving hundreds of millions of dollars.[23] Indeed, after only a few months under the revamped program, Whitlock noted a stunning increase in the size of unpaid tax liabilities reported by informants, a magnitude never seen "in the preamendment days."[24] Only a few months later, in October 2007, the Whistleblower Office received its first $1 billion submission, followed closely by a $2 billion submission.[25]

No doubt informants have been motivated by the promise of hefty cash rewards. The 2006 amendments to section 7623 added an entirely new subsection, "Awards to whistleblowers," which significantly increased potential bounties for exposing tax violations.[26] Under the new subsection, the Secretary is authorized to pay whistleblowers between 15% and 30% of the collected proceeds, including penalties, interest, additions to tax, and any other amounts resulting from the action.[27] Prior law made the payments discretionary, depending on what the District Director "deem[ed] to be adequate compensation in the particular case," which generally did not exceed 15% of the amounts collected.[28] Prior law also capped rewards at $2 million (and at $50,000 as late as 1989),[29] while the amended statute includes no cap on the absolute dollar amount that can be awarded. The statute provides for reduced awards in cases of less "substantial contribution," generally defined as cases involving previously disclosed public information or allegations.[30] In such instances, the Whistleblower Office may

21. IR-News Rel. 2007-25.

22. Stamper, *supra* note 8.

23. Tom Herman, *Whistleblower Law Scores Early Success, Higher Rewards Attract Informants Submitting Tips*, Wall St. J., May 16, 2007, at D3 (quoting Director Whitlock).

24. Jeremiah Coder, *Tax Analysts Exclusive: Conversations: Stephen Whitlock*, 116 Tax Notes (TA) 98 (July 9, 2007).

25. J.P. Finet, *Tax Whistleblower Action Claims $1 Billion Underpayment by Fortune 500 Company*, Daily Tax Rep. (BNA), Oct. 12, 2007, at G-5; J.P. Finet, *Whistleblower Action Claims Major Firm Underpaid Its U.S. Taxes by $2 Billion*, 238 Daily Tax Rep. (BNA), Dec. 12, 2007, at G-9.

26. Awards to Whistleblowers, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922 (2006) (adding subsection (b)).

27. I.R.C. § 7623(b)(1).

28. Reg. § 301.7623-1(c).

29. *See* IRS Publication 733 (rev. 7-80). The cap was raised to $100,000 in 1990. *See* IRS Publication 733 (rev. 11-90).

30. I.R.C. § 7623(b)(2)(A). The specific language relating to "less substantial contribution" involves actions based on allegations "resulting from a judicial or administrative hearing, from a governmental report, hearing, audit, or investigation, or from the news media."

award such sums it considers appropriate but in no case more than ten percent of the collected proceeds. Awards can also be reduced or denied in the event the Whistleblower Office determines that an informant "planned and initiated" the abusive behavior providing the basis of the award claim.[31] In the event of an award, whistleblowers may take an above-the-line deduction for attorneys' fees and costs paid to recover the award.[32]

III. WHAT ANIMATED THE CHANGES?

There are three primary reasons for the recent amendments to the Service whistleblower program. First, the program was broken. In June 2006, the Treasury Inspector General for Tax Administration (TIGTA) issued a report detailing the various shortcomings of the Service Informants' Rewards Program, which previously administered the authority provided under section 7623.[33] The program suffered from decentralized management, poor oversight, lack of standardization with respect to informant tips and Service payments, and inefficient processing of claims, examinations, and rewards. In particular, TIGTA found that the program was administered in ad hoc fashion by Service campuses spread throughout the country, each of which had "traditionally operated as a semi-autonomous entity."[34] For instance, the five geographically dispersed Informants' Claims Examiner (ICE) units tracked claim inventory differently, and none implemented ongoing oversight programs to monitor performance, such as operational reviews or management assistance. Moreover, the Service did not operate a nationwide database of informants' claims, thereby creating severe inconsistencies in the handling of claims and payments. TIGTA found that 45% of the case files it examined for informant claims suffered basic control issues, such as missing copies of key forms and no record of letters to informants. It further found that in 32% of the cases, the ICE reviewer offered no justification for the percentage awarded to the informant. And for rejected claims in its sample, TIGTA found that in 76% of the cases reviewers failed to offer any explanation or rationale for rejecting the claim.

In addition, TIGTA reported that informant claims languished in administrative and judicial processes for years. On average it took 7.5 years between the filing of a claim by an informant and the payment of a reward. Untimely processing of claims, TIGTA observed, made the rewards "lose some of their motivating value" with respect to encouraging informants to come forward with information.[35] For a program that largely existed to provide incentives for pri-

31. I.R.C. § 7623(b)(3).

32. I.R.C. § 62.

33. Treasury Inspector General for Tax Administration (TIGTA), The Informants' Rewards Program Needs More Centralized Management Oversight, 2006-30-092 (June 6, 2006).

34. *Id.* at 7.

35. *Id.* at 8. Informants are paid after the Service collects additional taxes, fines, and penalties from the alleged misconduct. *See* Reg. § 301.7623-1(a) (stating that rewards provided by section 7623 and the regulations "will be paid from the proceeds of amounts (other than interest) collected by reason of the information provided").

vate enforcement of the tax laws, it is hard to imagine that the average taxpayer even knew the program existed. The Service did not promote the program in any meaningful way, its website did not contain any information with respect to the program, and its webpage for reporting tax fraud did not even mention the availability of rewards.[36]

According to FTC Commissioner William Kovacic, one reason to pay generous bounties under laws that provide for private enforcement is to compensate the informant for endangering investment in her career and damaging reputation in her community.[37] The old Informants' Reward Program failed to provide such an incentive, with paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts. Until as late as 1989, the program capped awards at $50,000.[38] In 2004, the Service raised the top award from $2 million to $10 million, but neglected to address the other systemic problems that prevented the promise of more lucrative awards from providing sufficient incentive for informants to come forward with evidence of tax violations.[39]

Even with rising caps, rewards paid to informants remained low. Between 1989 and 1998, 95,105 claims for rewards were submitted under the old Service program, but only 6,310 claims were allowed in full or in part (6.63% of claims) with only $29,227,222 paid out to informants of the $1,450,808,529 recovered by the government (2.01% of collections).[40] Compared to other federal whistleblower rewards programs, the Service program was particularly ungenerous. During the same period between 1989 and 1998, government recoveries under the False Claims Act totaled $2,300,589,823, with $360,573,093 paid out to private individuals, for a payout rate of 15.7%.[41] In addition, while

36. *Id.* at 2.

37. William E. Kovacic, *Private Monitoring and Antitrust Enforcement: Paying Informants to Reveal Cartels*, 69 Geo. Wash. L. Rev. 766, 772 (2001); William E. Kovacic, *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 Loy. L.A. L. Rev. 1799, 1819 (1996).

38. *See supra* note 29.

39. *See* 1 IRS Organization, I.R.M. (CCH), ¶ 795 at 2389 (2007).

40. Terri Gutierrez, *IRS Informants Reward Program: Is It Fair?*, 84 Tax Notes (TA) 1203, 1205 tbl.1 (Aug. 23, 1999). Frequency and size of rewards were even lower in earlier years of the program. Between 1982 and 1986, there were 34,123 claims for rewards, but only 3,516 claims allowed in full or in part (10% of claims), with only $5,056,122 paid out to informants of the $392,038,826 collected by the government (1.3% of recoveries). Mark Uhlfelder, *Financial Rewards for Ratting on Tax Cheats Are Small and Rare*, 37 Tax Notes (TA) 1300, 1301 (Dec. 28, 1987). Comparing claims paid to claims submitted using short time horizons may yield misleading results. Awards can only be paid to informants from collected proceeds (*see supra* note 35), thereby creating a lag between submission of a claim and payment of an award. Moreover, as the TIGTA reported in its June 2006 report, the Service has historically taken an average of 7.5 years to process successful informant claims (including examination, assessment and collection of tax owed, and waiting for taxpayers to exhaust appeals rights). TIGTA, *supra* note 33, at 8. Therefore, while it is reasonable to assume that some claims submitted during a defined period of years are paid during the period, it is also likely that claims paid would include claims submitted *prior* to the period in question and equally likely that claims submitted would include claims resulting in payments made *after* the period. If the government possessed data linking submission dates to payment dates (which it currently does not), it might find no meaningful difference between comparing claims paid to claims submitted with or without the data. However, until the government generates such data, we cannot assume a link between claims submitted for a particular time horizon and claims paid for that horizon. I am grateful to Stephen Whitlock for sharing this caveat.

41. Calculated from U.S. Department of Justice, Civil Division, Fraud Statistics Overview, (Oct. 1, 1986–Sept. 30, 2006), *available at* http://www/lopds.com/files/pdf/stats-fy2006.pdf.

annual recoveries under the Service whistleblower program have never crested $100 million,[42] recoveries continue to climb under the FCA, topping $1.4 billion in 2006.[43]

Given the above numbers, it is clear that whistleblowers under the Service program have had a harder time than other federal whistleblowers collecting their share of judgments and settlements. Courts have contributed to this difficulty by preventing informants from enforcing their claims to rewards. A study of all court cases between 1941 and 1998 filed by informants against the Service seeking a redetermination of amounts awarded (a total of 19 cases) found that the taxpayer lost every case.[44] In particular, courts have sided overwhelmingly with the government with respect to the Service's exclusive discretion in determining whether to award payments to whistleblowers at all[45] as well as the amount of any award.[46] Moreover, for an informant to have a claim on which relief can be granted, there must be some affirmative agreement between the government and the informant; a mere offer for an award (either through section 7623, regulations, or Service publications) does not create a contract (implied or otherwise) between the informant and the government.[47]

The second explanation for why Congress passed the recent amendments to the Service informants' program is that legislators recognized that an improved whistleblower statute could be an effective weapon against noncompliance. The report issued by TIGTA in June 2006 noted that despite room for improvement, the Informants' Rewards Program had "significantly contributed to the IRS' efforts to enforce tax law," and that additional management focus "could enhance the effectiveness of the Program as an enforcement tool."[48] The report also noted that examinations of taxpayer returns initiated by information supplied

42. TIGTA, *supra* note 33, at 3.

43. U.S. Department of Justice, *supra* note 41.

44. Gutierrez, *supra* note 40, at 1205-06.

45. *See, e.g.*, Krug v. United States, 168 F.3d 1307, 1309 (Fed. Cir. 1999) (affirming summary judgment for government in informant's suit to recover a reward because, among other things, the Service did not abuse its discretion in deciding not to pay an award); Saracena v. United States, 508 F.2d 1333, 1336 (Ct. Cl. 1975) (Service District Director has complete discretion to determine whether reward should be paid to informant).

46. *See, e.g.*, Katzberg v. United States, 36 F. Supp. 1023, 1023 (Ct. Cl. 1941), *cert. denied*, 314 U.S. 620 (1941) (determining Commissioner has total discretion to determine size of award); *Saracena*, 508 F.2d at 1336 (absent a showing of unreasonableness, the District Director has complete discretion to determine the size of award).

47. *See, e.g., Krug*, 168 F.3d at 1309 (affirming summary judgment for government in informant's suit to recover a reward because, among other things, an enforceable contract arises only after an informant and the Service negotiate and fix a specific award, and neither section 7623 nor Publication 733 create an implied-in-fact contract for payment); Diamond v. United States, 213 Ct. Cl. 766 (1977) (offer of an award from Service to informant does not create a contract between Service and informant, and informant is not automatically entitled to an award); Lagermeier v. United States, 214 Ct. Cl. 758 (1977) (offer to pay reward by the Service is only an offer to pay such reward as District Director deems suitable; no contract is otherwise created); *Katzberg*, 36 F. Supp. at 1023 (offering an award from the Service to informant does not create a contract between Service and informant, and informant is not automatically entitled to an award). A lesser-known program, the Special Agreement Program, has historically allowed informants to enter into contracts with the Service stipulating the parties' understanding of what percentage the whistleblower would receive in the event the Service obtained a recovery. The Service has been reluctant to enter into such contracts, and according to *qui tam* attorney Paul Scott, "has tended in practice to reserve those agreements only for information associated with high-dollar recoveries." Paul D. Scott, *Tax Whistle-Blowers to Receive Increased Awards*, 114 Tax Notes (TA) 441, 442 (Jan 29, 2007).

48. *See* TIGTA, *supra* note 33, at 1.

by private informants were nearly twice as "effective and efficient" (measured by dollars recovered per hour of examination time) than examinations initiated by the Service's primary statistical method for selecting returns.[49] The reward program's potential effectiveness as a compliance tool resonated particularly loudly with a Congress nearly obsessed with closing the "tax gap."[50] In 2006, the Service reported that the gap approached a record $350 billion for tax year 2001,[51] reflecting a compliance rate of 83.7%.[52] Assuming that the tax gap grows in proportion to increased tax liability, the $350 billion figure for 2001 is equivalent to a $400 billion tax gap for 2006.[53] According to recent Congressional estimates, a fully funded whistleblower program would raise at least $400 million over ten years, narrowing the distance between what taxpayers pay and what they should pay.[54] Given the high-dollar submissions ($1 billion and $2 billion) to the Whistleblower Office in its first year of operation,[55] this estimate may prove

49. The Service uses the Determinant Index Function (DIF) to select returns for audit. DIF evaluates income tax returns for potential examination by assigning weights to various return characteristics. *See* TIGTA, *supra* note 33, at 1–2 and 4–5. It is important to note that the selection criteria for informant claims cases, if applied properly, would *always* result in informant claims cases yielding more effective returns than DIF selected cases. The Service pursues cases based on informant leads that appear more likely to yield productive results than cases based on other sources, including DIF selected cases. Thus, an informant lead that appears less productive than a DIF lead will not be pursued by the Service. I am grateful to Stephen Whitlock for this information.

50. *See supra* note 13. Congress has spent much of the last year trying to figure out how to close the gap, and the Treasury Department has responded with a number of policy recommendations. *See, e.g.*, James M. Bickley, Congressional Research Service, Tax Gap and Tax Enforcement, CRS RL338882 (Aug. 13, 2007); Internal Revenue Service and Department of the Treasury, Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance (2007); U.S. Department of the Treasury, Office of Tax Policy, A Comprehensive Strategy for Reducing the Tax Gap (2006).

51. The "gross" tax gap was estimated at $345 billion, but does not account for taxes paid voluntarily though late or for recoveries from Service enforcement activities, which, together, reduce the "net" tax gap to an estimated $290 billion for a compliance rate of 86.3%. *See IRS and the Tax Gap: Hearing Before the H. Comm. on Budget*, 110th Cong. (2007) (statement of J. Russell George, Treasury Inspector General for Tax Administration), *available at* http://www.house.gov/budget_democrats/hearings/2007/08Georgetestimony.pdf.

52. Press Release, Department of the Treasury, Testimony of Treasury Assistant Secretary for Tax Policy Eric Solomon before the Senate Finance Committee on Ways to Reduce the Tax Gap (Apr. 18, 2007), *available at* http://www.treasury.gov/press/releases/hp360.htm. The gap would be even larger if not for involuntary forms of tax payment. The administrative mechanisms of withholding and information reporting generate phenomenally high rates of compliance by making third parties (usually employers) responsible for reporting and paying a taxpayer's taxes. *See* Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 Stan. L. Rev. 695 (2007). The misreporting or noncompliance rate for withholding (associated with wage and salary income) barely tops one percent, while the noncompliance rate for information reporting (interest and dividend income) is an estimated 4.5%. Internal Revenue Service, Tax Gap Figures (2006), *available at* http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf. Comparatively, the rate for income not subject to withholding or information reporting, such as small business income, is an astounding 53.9%. *Id.* Thus, breaking out the income reported through withholding and information reporting results in a "voluntary" compliance rate significantly below official estimates. *See* Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 Kan. L. Rev. 971, 972–76 (2003). Some of the recent proposals to close the tax gap recognize the necessity of relying on information reporting and withholding strategies. *See* Internal Revenue Service and Department of the Treasury, *supra* note 50; U.S. Government Accountability Office, Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap, GAO-07-391T (2007).

53. Eric Toder, *Reducing the Tax Gap: The Illusion of Pain-Free Deficit Reduction*, Urban Institute-Brookings Institution Tax Policy Center (2007).

54. Wesley Elmore, *Finance Approves Small-Business Tax Breaks, Complete with Offsets*, 114 Tax Notes (TA) 267, 268 (Jan. 22, 2007).

55. *See supra* note 25.

wildly conservative, with additional tax collections reaching hundreds of millions of dollars per year.

Finally, Congress expanded the Service whistleblower program thanks in large part to the indefatigable efforts of Senator Grassley. Grassley, a longtime advocate of strengthened whistleblower statutes, had been an architect of the 1986 amendments to the False Claims Act, which transformed the statute into the government's most powerful mechanism for private enforcement of public laws.[56] Moreover, in 2004, Grassley championed an office within the Service explicitly to oversee whistleblower claims and awards.[57] Furthermore, when the TIGTA released its 2006 report criticizing aspects of the Informants' Rewards Program, Grassley used the opportunity to urge Congress and the Service to overhaul the whistleblower program so that private citizens could more easily "blow the whistle on big tax cheats."[58] Also in 2006, Grassley's office drafted legislation providing the basis for the new Whistleblower Office and awards program.[59]

Indeed, Grassley and other legislators have recognized the compliance enhancing potential of a coordinated program for tax whistleblowers. As supporters shape and fine-tune the new program during its formative stages,[60] it would be prudent to examine the most successful whistleblower statute to date, and one that could serve as a model: the False Claims Act.

IV. WHAT'S WORKED BEFORE?

The False Claims Act is the lodestar of private enforcement of public law, boasting "tremendous success in attracting tips regarding fraud against federal government programs."[61] Since 1986, the year Congress passed significant amendments to the FCA,[62] recoveries under the program have skyrocketed, from zero in 1987 to over $1.4 billion in 2006.[63] Logistically, the FCA is enforced by the Department of Justice, and pays bounties to informants for tips on fraud against federal government programs. It creates civil liability for any person who knowingly submits a false claim for payment to the federal government, knowingly uses a false statement to induce the payment of a false claim, conspires to de-

56. For further discussion of the False Claims Act as a model of private enforcement of public laws, see *infra* notes 61–84 and accompanying text.

57. *See supra* note 6.

58. Wesley Elmore, *Grassley: TIGTA Report Validates Concerns Over Reward Program*, 111 Tax Notes (TA) 1342, 1342 (June 19, 2006).

59. *Id.*

60. Service Whistleblower Office Director Stephen Whitlock has said that existing Service "policies regarding tax informants will need to be amended or abolished to conform" to the new bounty legislation. *See* Stephen Joyce, *Whitlock Outlines Whistleblower Office Plan; IRS, Treasury Officials Cite Lack of Guidance*, 24 Daily Tax Rep. (BNA), Feb. 6, 2007, at G-6. This will be a big task, and one that could benefit from examining precedential programs.

61. Scott, *supra* note 47, at 442.

62. *See* False Claims Amendments Act, Pub. L. No. 99-562 (1986) (codified as amended at 31 U.S.C. §§ 3729–3731 (2000)).

63. U.S. Department of Justice, *supra* note 41.

fraud the government to pay a false claim, or knowingly uses a false statement to decrease an obligation to pay money to the government.[64] A "claim" under the FCA consists of any request or demand for money or property where the federal government pays any portion of the money or property in question.[65] Moreover, the statute defines "knowing" conduct as actual knowledge of false information as well as "deliberate ignorance" or "reckless disregard" of the truth.[66] The decision to prosecute on the basis of an informant's tip and information is delegated to the Attorney General and the Department of Justice[67] as well as to the informant or "private person."[68] If the government declines to proceed with the action, the informant may continue alone as a *qui tam* plaintiff in the name of the government.[69] However, the Attorney General can still decide to motion the court to dismiss the action.[70] Actions brought by private persons under the FCA are brought in the judicial district in which the defendant resides, transacts business, or in which any alleged activity proscribed by the statute occurred.[71]

With respect to awards for informants, if the government proceeds with the action, the whistleblower "shall . . . receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim" depending upon the extent to which the whistleblower "substantially contributed" to the prosecution of the action.[72] In addition, there is no absolute dollar cap on the amount that can be awarded. If the court finds that the action is based primarily on publicly available information or information otherwise available to the government rather than specific and unique information provided by the private person, it may award "such sums as it considers appropriate," but not more than ten percent of the proceeds of the action or settlement.[73] The informant will also receive payment for reasonable expenses including attorneys' fees and costs.[74] If the government does *not* proceed with the action and the whistleblower successfully prosecutes the case, the whistleblower will receive an amount that the court decides is reasonable, but not less than 25% and not more than 30% of the proceeds or settlement.[75] Again, there is no absolute dollar cap on the amount that can be recovered, and the informant will be reimbursed for reasonable expenses.

Under certain conditions, a whistleblower's award can be reduced. For instance, if the court determines that the action was brought by an informant who "planned and initiated the violation" upon which the action was brought, the

64. 31 U.S.C. § 3729(a) (2000).

65. *Id.* § 3729(c).

66. *Id.* § 3729(b).

67. *Id.* § 3730(a).

68. *Id.* § 3730(b).

69. *Id.* § 3730(b)(4).

70. *Id.* § 3730(b)(1).

71. *Id.* § 3732.

72. *Id.* § 3730(d)(1).

73. *Id.*

74. *Id.*

75. *Id.* § 3730(d)(2).

court may decrease the share of the proceeds received taking into consideration "the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation."[76] Furthermore, if the person bringing the action is convicted of criminal conduct arising from her role in the violation, she shall be dismissed from the civil action and not receive any share of the proceeds.[77] If the government opts not to prosecute the action, but the person bringing the action goes forward as a *qui tam* plaintiff, the court may award the *defendant* reasonable attorney's fees and expenses if the defendant prevails and the court finds that the claim was "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[78]

The FCA also bars certain actions from the whistleblower statute. The two most pertinent for our discussion include a jurisdictional barrier as well as an absolute bar to actions involving allegations under the Code. First, courts do not have jurisdiction over actions based upon "the public disclosure" of allegations or transactions unless the action is brought by the Attorney General or the informant qualifies as an "original source of the information."[79] A person is considered an "original source of the information" if she "has direct and independent knowledge" of the information underlying the allegations, and has provided the information to the government before filing a *qui tam* action.[80] This requirement has proven to be a meaningful jurisdictional barrier for *qui tam* plaintiffs, and the basis for dismissal of many *qui tam* actions.[81] Recently, the Supreme Court strictly construed the FCA's "original source" requirement to mean that an informant must have knowledge of the actual facts underlying the allegations on which he may ultimately prevail, thereby making it even more difficult for *qui tam* plaintiffs to prosecute and prevail in actions against persons submitting false claims to the government.[82]

The second bar prevents *qui tam* plaintiffs from enforcing the nation's tax laws. The FCA does not apply to "claims, records, or statements made under the Internal Revenue Code of 1986."[83] Thus, to the extent legislators like Senator Grassley envisioned bringing *qui tam* to tax in the hope that private enforcement of tax laws would prove as effective as private enforcement of other public laws, they needed to provide an independent enforcement statute. Section 7623 and the Informants' Rewards Program already existed. In 2006, Congress simply enhanced the program, adding a few bells and whistles.[84]

76. *Id.* § 3730(d)(3).

77. *Id.*

78. *Id.* § 3730(d)(4).

79. *Id.* § 3730(e)(4)(A).

80. *Id.* § 3730(e)(4)(B).

81. *See, e.g.*, Robert L. Vogel, *The Public Disclosure Bar Against Qui Tam Suits*, 24 Pub. Cont. L.J. 477, 491-99 (1995) (describing the difficulties faced by *qui tam* plaintiffs in overcoming the public disclosure jurisdictional barrier).

82. *See* Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397, 1409 (2007).

83. 31 U.S.C. § 3729(e) (2000).

84. Pun intended.

V. WHY *QUI TAM* FOR TAX?

The recent enhancements to section 7623 and the creation of a Service Whistleblower Office have provided significantly heightened incentives for informants to come forward with information about undetected tax avoidance activity. As the last section demonstrated, this kind of private enforcement of public laws has proven effective in exposing fraud committed against the federal government. But is it appropriate to apply the private enforcement model to such an essential government function as the monitoring and enforcement of the internal revenue laws? Moreover, is it appropriate for private citizens to enforce the nation's tax laws when application of fact to law contains countless unknown outcomes, and the "right" answer is ambiguous at best? In many ways, tax law is stochastic, with no clear law at all. The law itself often becomes a random variable, with a certain probability that it is X and a certain probability that it is Y. Add the difficulty of assigning a particular probability to the different outcomes—to say nothing of the fact that regulators and courts can express preferences for form, substance, or any point in between—and making accurate assessments of reporting positions and transactions can become a task of partially informed guesswork. In a world of such uncertainty, do we really want private persons enforcing the law? For the reasons set forth below, the answer is, "Yes."

A. Increasing Transparency with Private Enforcement

Private enforcement of public law is particularly appropriate when regulators, due to asymmetric information and active concealment on the part of regulated entities, are unable to enforce and prosecute the law effectively. In the world of tax regulation, taxpayers and their advisors possess the information that tax regulators seek. The goal is to keep as much of the information from the regulators as possible, and taxpayers pay considerable sums of money to those advisors most skilled at concealment. In this cat-and-mouse game, it is appropriate as well as efficient to provide incentives for private persons to come forward with information and reveal details about what Professor Mark Gergen has called "the common knowledge of tax abuse."[85] Indeed, as FTC Commissioner Kovacic has said with respect to private enforcement of cartels, "[o]ne way to counter greater efforts at concealment is to establish mechanisms for inducing [] insiders to disclose their misconduct."[86] "Private monitoring," Kovacic argues, "can be an antidote to concealment";[87] it can be "particularly destabilizing where the success of an illegal practice requires covert collective action."[88] Professor Joshua Rosenberg made a similar observation ten years ago when contemplating the benefits of bringing *qui tam* litigation to tax. "As has happened with the

85. Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. Rev. 131 (2001).

86. Kovacic, *supra* note 37, at 767.

87. *Id.* at 774.

88. *Id.*

current *qui tam* provisions," Rosenberg wrote, referring to the False Claims Act, "some large tax *qui tam* cases would likely attract significant media attention. Attorneys, accountants, and other tax planners and tax compliance personnel would realize that they could no longer rely on the silence and acquiescence of others, and that cheating on taxes had become a dangerous sport both for their employer and, because their participation would inevitably be exposed, for themselves."[89] If sunlight is the best antiseptic, the looming possibility of *qui tam* actions could alter risk assessments of reporting positions by taxpayers and their advisors and thereby improve tax compliance.

As currently written, section 7623 is a whistleblower statute, not a *qui tam* statute. It pays bounties to private citizens for detecting underpayments of tax and assisting the successful prosecution of tax cheats. But unlike the FCA, if the government declines to prosecute the alleged tax violation, the private citizen cannot proceed with the action on her own. This Article argues that extending *qui tam* to tax, though not without potential pitfalls, can be a particularly effective weapon in the government's tax compliance arsenal. It argues further that a strong *qui tam* approach would not necessarily deprive the government of its enforcement discretion respecting good faith differences in interpreting ambiguous tax rules. With procedures in place to reserve enforcement discretion to the Service—just as the FCA reserves such discretion to the Department of Justice—both the current bounty approach and this Article's recommended *qui tam* approach can effectively reinforce the government's compliance efforts.

B. Taxpayer Privacy and Harassment Concerns

Two primary and frequently invoked problems associated with private enforcement of tax law, including bringing *qui tam* to tax, involve privacy and harassment concerns. Section 6103 prohibits the Service from disclosing "to any person in any manner whatever" information pertaining to tax returns.[90] The statute specifically authorizes disclosure of tax return information to certain persons, including individuals designated by the taxpayer; state tax officials; persons having a material interest in the information (the taxpayer herself, spouses, partners, and certain shareholders in a corporation); Congressional committees; the President and White House personnel; and the Treasury Department and the Department of Justice in civil and criminal tax cases. The concern among critics of private enforcement of the tax laws through either a bounty system or *qui tam* approach is that allowing private citizens to profit by disclosing taxpayer information would result in those individuals recklessly exposing information to persons not authorized by statute to receive such information.

89. Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy and How We Can Make Them Sane*, 16 Va. Tax Rev. 155, 211 (1996). Rosenberg's article represented the first scholarly examination of *qui tam* in the tax context. Recently, Rosenberg has offered additional insights on the subject in Joshua D. Rosenberg, *Narrowing the Tax Gap: Behavioral Options*, 117 Tax Notes (TA) 517, 525–31 (Oct. 29, 2007).

90. *See* I.R.C. § 6103(a), (b)(8).

This concern is invalid for at least two reasons. First, under the existing Service whistleblower statute and the federal *qui tam* statute, informants and *qui tam* plaintiffs, respectively, must turn their unique and specific information over to the government to initiate claims. Service informants disclose to the Treasury Department while *qui tam* plaintiffs disclose to the Department of Justice, two agencies already authorized under section 6103 to receive such information. Second, section 6103 protects distribution of tax return information obtained by the Service and other statutorily authorized agencies and persons, *not* by private individuals. A private informant who obtains information from the taxpayer or some other source is not covered by section 6103.

Even more generally, privacy concerns associated with the tax whistleblower statute and *qui tam* for tax must be balanced against public policies that encourage private persons to expose tax cheating and thereby increase transparency in the law. Though policymakers have historically considered the tax disclosure rules sacred, there is reason to believe that efforts to relax them for purposes of further enhancing the tax whistleblower statute might have some traction among current tax officials and legislators seeking increased transparency. For example, former Commissioner of Internal Revenue Mark Everson and Securities and Exchange Commission Chairman Christopher Cox recently advocated loosening section 6103 to facilitate information sharing between government agencies.[91] In fact, Everson recommended making corporate tax returns public,[92] a proposal with historical roots,[93] and one with at least some support from members of Congress.[94] Moreover, given recent congressional preoccupation with closing the tax gap,[95] relaxing disclosure rules further to allow private citizens to help the government collect unpaid tax revenues is not such a far-fetched idea. Also, if disclosure takes the form of campaigns that publicize the whistleblowing and *qui tam* activity, there is evidence to suggest that such publicity would raise tax compliance "by assuring compliant taxpayers that others are likely to comply" with the tax laws.[96] Indeed, researchers have shown that

91. Dustin Stamper, *SEC, IRS "Discuss" Making More Corporate Tax Data Public, Cox Says*, 81 Highlights & Doc. 794 (May 2, 2006).

92. Dustin Stamper, *Everson Makes Another Pitch for Transparency*, 2006 Tax Notes Today 241-2 (Dec. 15, 2006); Dustin Stamper & Allen Kenney, *Everson Calls for Debate on Making Corporate Returns Public*," 2006 Tax Notes Today 50-1 (Mar. 15, 2006).

93. The corporation excise tax of 1909, the precursor to the modern corporate income tax, included a publicity provision opening returns to public inspection. *See* Marjorie E. Kornhauser, *Corporate Regulation and The Origins of the Corporate Income Tax*, 66 Ind. L.J. 53, 94–136 (1990). In 1934, Congress required certain *personal* income tax information be made public. The law was repealed the following year. *See* Marjorie E. Kornhauser, *Shaping Public Opinion and the Law in the 1930s: How a "Common Man" Campaign Ended a Rich Man's Law*, Tulane Public Law Research Paper No. 06-02 (2006).

94. Sheryl Stratton, *Closing the Credibility Gap by Disclosing Corporate Returns*, 96 Tax Notes (TA) 322, 322 (July 15, 2002) (discussing calls from Senator Grassley to make corporate tax returns public).

95. For efforts to close the tax gap, see *supra* note 50.

96. Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 Ohio St. L.J. 1453, 1463 (2003); *see also* Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. Kan. L. Rev. 1065, 1076 (2003) (reporting that econometric and social norm theories of tax compliance indicate "that publicity campaigns highlighting the revenue authority's successful enforcement efforts can positively impact . . . taxpayer compliance").

the historically uncritical acceptance of taxpayer confidentiality has hindered rather than helped Service enforcement, while lower privacy protections could have the effect of increasing compliance.[97] Finally, though Congress explicitly excluded claims arising under the Code from the FCA in 1986, it did so "to allow the Internal Revenue Service to enforce the I.R.C. as it sees fit," rather than to protect taxpayer information.[98] Thus, it seems likely Congress would accept a "*qui tam* for tax" proposal so long as the plan reserves oversight and gatekeeping authority to the Service, and does not infringe on the agency's enforcement discretion, which is incident to its interpretive authority.

Harassment concerns appear more difficult to overcome. There would be nothing to stop *qui tam* plaintiffs from bringing actions on open questions of law, for instance, where regulators or courts or Congress had not provided sufficient guidance, or, as problematic, where regulators and courts and Congress provided conflicting guidance. Similarly, *qui tam* for tax could provide an opportunity for the plaintiffs' bar to generate lawsuits based on these ambiguities, conceivably with or without specific insider or informant information. Consider what *qui tam* for tax might have wrought between the Supreme Court's 1992 decision in *INDOPCO v. Commissioner*[99] and the Treasury Department's issuance of temporary regulations in 2002 pertaining to expensing and capitalizing intangibles.[100] In the intervening decade, the *qui tam* plaintiffs' bar could have conceivably brought lawsuits against every company that reported legal expenses or other professional costs on financial statements or other filings. These companies may have been trying in good faith to comply with the tax law, and either expensed the costs (as was customary and as the regulations subsequently provided) or capitalized them (as *INDOPCO* required). Without specific guidance from the government, it was hard to tell how to treat certain expenses under certain conditions. *Qui tam* litigation under these conditions of ambiguity and uncertainty would be harassing as well as counterproductive.

Concerns over harassing lawsuits under a hypothetical *qui tam* statute for tax, though real, are eminently surmountable. First, Congress could take a page out of the FCA and delegate to the Service the decision to prosecute a *qui tam*

97. *See* Christopher S. Rizek, *Taxpayer Privacy and Disclosure Issues Will Continue to Touch Us All*, *in* The Future of American Taxation: Essays Commemorating the 30th Anniversary of Tax Notes 81, 89 (2002) (noting the "intuitive persuasive power" of the argument that taxpayers "may be more likely to report accurate information to the government if their neighbors, business partners, and the entire world, not just the IRS, can review and analyze it"); George Guttman, *The Confidentiality Statute Needs Rethinking*, 86 Tax Notes (TA) 318, 320 (Jan. 17, 2000) (discussing how information sharing among government agencies and publishing lists of tax delinquents could increase compliance).

98. United States *ex rel.* Lissack v. Sakura Global Capital Mkts., Inc., No. 95-1363, 2003 U.S. Dist. LEXIS 14600, at *19 (S.D.N.Y. Aug. 21, 2003); *see also* United States *ex rel.* Mikes v. Straus, 853 F. Supp. 115, 119 (S.D.N.Y. 1994) (holding that the FCA did not permit subject matter jurisdiction over false tax claims and that such tax "matter[s] [should be] reported to the [Service], to permit it to determine what inquiries, if any, may be called for under the circumstances"); Boese, *supra* note 11, at § 2.02[H], Tax Claims.

99. 503 U.S. 79 (1992).

100. *See Guidance Regarding Deduction and Capitalization of Expenditures*, Prop. Reg. §§ 1.167(a)-3, 1.263(a)-4, 1.446-5, 67 Fed. Reg. 77,701-01 (2002). I am grateful to Kristin Hickman for providing this example to help explain why we might be wary of extending *qui tam* to tax.

taxpayer (the FCA vests such authority in the Attorney General).[101] If the Treasury declined to proceed with the action, the informant could pursue the matter alone as a *qui tam* plaintiff, and the Commissioner could still move the court to dismiss actions deemed meritless.[102] Essentially, the Service would be placing claims into three categories: (1) government prosecution; (2) express dismissal; and (3) colorable claim where the *qui tam* plaintiff could proceed on her own, subject to rules similar to those imposed by the FCA for receipt of award payments associated with successfully prosecuted actions.[103]

Second, if a situation arises like the one described above with respect to *INDOPCO* and the subsequent legal ambiguity of the Court's decision, courts could abstain or otherwise stay *qui tam* cases pending resolution of the ambiguity. Under this recommendation, in the period between *INDOPCO* and the issuance of regulations, *qui tam* cases could have been stayed to avoid conflicting legal determinations between the judicial and executive branches.

Third, Congress could minimize the possibility of harassing claims by restricting *qui tam* tax litigation to high-dollar cases. Current law limits informant claims to cases against taxpayers whose gross annual income exceeds $200,000 and whose potential indebtedness for taxes, penalties, and interest exceeds $2,000,000.[104] If Congress felt that existing limits were too low, it could raise them for cases prosecuted by *qui tam* plaintiffs.

Fourth, to discourage the plaintiffs' bar from aggressively collecting *qui tam* plaintiffs, Congress could require informants to provide specific and unique information before the Service and the court could authorize them as *qui tam* plaintiffs. It could, for instance, require would-be plaintiffs to meet the Supreme Court's recent interpretation of the FCA's "original source" rule whereby an informant must have knowledge of the actual facts underlying the allegations on which she believes she can prevail.[105] In addition, the current tax whistleblower statute merely reduces awards to informants the Service determines do not possess specific and unique information.[106] Alternatively, Congress could prohibit such informants from prosecuting actions altogether.

Finally, experience under the FCA indicates that allowing *qui tam* plaintiffs to prosecute actions without the government has not resulted in a flood of harassing or frivolous lawsuits. With the Department of Justice and courts acting as gatekeepers, illegitimate *qui tam* claims get screened out early in the process. Moreover, those *qui tam* plaintiffs who manage to make it through the screening process and proceed with the action independent of the government receive a small portion of all *qui tam* settlements and judgments. Between 1987 and

101. 31 U.S.C. § 3730(a) (2000).

102. The FCA, for its part, requires both the court and the Attorney General to give written consent for dismissal of an action in the event the government decides against prosecution. *See id.* § 3730(b)(1).

103. *See id.* § 3730(d)(2).

104. I.R.C. § 7623(b)(5).

105. *See* 31 U.S.C. § 3730(e)(4)(A), (B) (2000); *see also* Rockwell Int'l Corp. v. United States, 127 S. Ct. 1397, 1409 (2007); Vogel, *supra* note 81, at 491–99.

106. *See* I.R.C. § 7623(b)(2)(a).

2006, just 3.6% of all *qui tam* settlements and judgments went to *qui tam* plaintiffs suing alone, while in 2006, *qui tam* plaintiffs received only 1.17% of all *qui tam* collections.[107] The experience of the FCA indicates that the low expected financial payout associated with prosecuting *qui tam* actions that the government decides not to pursue, presumably the weakest cases, may discourage individuals from bringing such actions.[108]

C. Recalculating the Compliance Calculus and Closing the Resource and Information Gaps

The benefits of extending *qui tam* litigation to tax significantly outweigh any potential shortcomings. The possibility of *qui tam* actions adds downside risk, both real and perceived, to the compliance calculus by increasing the probability of detection as well as subsequent prosecution. The mere threat of *qui tam* investigations and lawsuits initiated by knowledgeable insiders could discourage noncompliant behavior. Meanwhile, successful prosecution of tax violators and widely publicizing the conviction of illegal behavior could both discourage noncompliant behavior and reinforce compliant behavior.[109] People pay taxes for various reasons. But fear of detection, more than the size of potential penalties, seems to provide the strongest incentive to comply with the tax law.[110]

107. Calculated from U.S. Department of Justice, *supra* note 41.

108. The low expected payouts associated with prosecuting *qui tam* actions independent of the government does not necessarily lead to the conclusion that adding a *qui tam* provision to the current tax whistleblower statute would provide no marginal benefit to the existing bounty system. *See infra* notes 142–46 and accompanying text.

109. *See supra* notes 96–97 and accompanying text.

110. This is not to say that tax penalties cannot have a positive impact on compliance. *See* James Alm, Isabel Sanchez & Ana De Juan, *Economic and Noneconomic Factors in Tax Compliance*, 48 Kyklos 3 (2001); Ana De Juan, Miguel A. Lasheras & Rafaela Mayo, *Voluntary Tax Compliant Behavior of Spanish Income Tax Payers*, 49 Pub. Fin. 90 (Supp. 1994); Steven Klepper & Daniel Nagin, *Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution*, 23 Law & Soc'y Rev. 209 (1989). But researchers have shown that nominal penalties do not correlate as strongly as probability of detection with increased compliance. *See* Joel Slemrod, Marsha Blumenthal & Charles W. Christian, *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota*, 79 J. Pub. Econ. 455 (2001); A. Mitchel Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 Harv. L. Rev. 869 (1998); Kurt J. Beron, Helen V. Tauchen & Anne D. Witte, *The Effect of Audits and Socioeconomic Variables on Compliance*, *in* Why People Pay Taxes 67 (Joel Slemrod ed. 1992); Jeffrey A. Dubin & Louis L. Wilde, *An Empirical Analysis of Federal Income Tax Auditing and Compliance*, 41 Nat'l Tax J. 61 (1988); Jeffrey A. Dubin, Michael J. Graetz & Louis L. Wilde, *Are We a Nation of Tax Cheaters?: New Econometric Evidence on Tax Compliance*, 77 Am. Econ. Rev. 240 (1987). In fact, some studies have reported a "crowding out" of tax compliance when penalties are introduced, and a corresponding *increase* in evasion. *See* Valerie Braithwaite, *Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions*, *in* Taxing Democracy: Understanding Tax Avoidance and Evasion 15 (Valerie Braithwaite ed. 2003); Doreen McBarnet, *When Compliance Is Not the Solution but the Problem: From Changes in Law to Changes in Attitude*, *in* Taxing Democracy: Understanding Tax Avoidance and Evasion 229 (Valerie Braithwaite ed. 2003); Mark Lubell & John T. Scholze, *Cooperation, Reciprocity, and the Collective-Action Heuristic*, 45 Am. J. Pol. Sci. 160 (2001); Bruno Frey, *A Constitution for Knaves Crowds Out Civic Virtues*, 107 Econ. J. 1043 (1997). In the end, neither the traditional deterrence strategy nor the punishment strategy fully explains why people pay taxes. Moral, ethical, and social inputs are as important in determining whether and how taxpayers comply with the law as the threat of economic or legal punishment. *See* Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 Iowa L. Rev. 863, 916-21 (2004); Lederman, *supra* note 96; Marsha Blumenthal, Charles Christian & Joel Slemrod, *Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota*, 54 Nat'l Tax J. 125 (2001); Dan M. Kahan, *Trust, Collective Action, and Law*, 81 B.U. L. Rev. 333 (2001); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 Va. L. Rev. 1781 (2000); Brian Erard & Jonathan S. Feinstein, *The Role of Moral Sentiments and Audit Perceptions in Tax Compliance*, 49 Pub. Fin.

In a world of inadequate enforcement and stupendously low audit rates, *qui tam* litigation could augment government efforts to detect abusive taxpayer behavior. In 2006, the Service audited less than one percent of all individual returns,[111] and even then could not verify all positions embedded in examined returns.[112] The other 99% of the time, the opposing party's assertions went unexamined and unchallenged. In addition, despite higher absolute audit rates for businesses, examinations and probability of detection continue to decline. In 2006, exams of companies with assets of more than $10 million decreased 7.5%, to 18.6%, while for companies with assets of more than $250 million audits dropped 25%, to 35.3%.[113] Even for corporations subject to annual audit, there is no guarantee the Service will identify questionable tax-motivated transactions, either because of gaps in the corporate taxpayer's records,[114] affirmative concealment of questionable transactions,[115] or the ability of corporations to set the audit agenda and include for scrutiny legitimate transactions while excluding illegitimate transactions.[116] Finally, even though absolute dollar amounts from enforcement have increased in recent years,[117] the Service has left a significant amount of money on the table. The Service audited 50% fewer total companies between 1997 and 2006.[118] For every category of business taxpayer—including small business, large corporation, and tax-exempt—the Service performed fewer audits in 2006 than in 1997.[119] In addition, the Service has begun allocating fewer hours to each audit,[120] and allegedly pressuring agents to close audits of large corporations prematurely as part of negotiated compromises.[121] Private

70 (Supp. 1994); Laurie Mason & Robert Mason, *A Moral Appeal for Taxpayer Compliance: The Case for a Mass Media Campaign*, 14 L. & Pol'y 381 (1992); Harold G. Grasmick & Robert J. Bursick, *Conscience, Significant Others, and Rational Choice: Extending the Deterrence Model*, 24 Law & Soc'y Rev. 837 (1990).

111. Stephen Joyce, *IRS Official Says Personal Audits to Rise, Corporate Audit Strategies Being Developed*, Daily Tax Rep. (BNA), Dec. 21, 2006, at G-7 (citing 0.98%); Stephen Joyce, *IRS Collected Record $48 Billion in FY 2006; Increases in Individual, Business Audits Cited*, Daily Tax Rep. (BNA), Nov. 21, 2006, at G-5. Individuals claiming income of $100,000 or more faced an audit rate of 1.67%, while those claiming income under $100,000 confronted an audit rate of just 0.89%.

112. *See* Rosenberg, *supra* note 89, at 189 ("Even if the Service does audit the taxpayer, it may not notice whatever tax evasion the taxpayer may have engaged in. To the extent that it must rely on the taxpayer's own records to incriminate the taxpayer, the Service is in a difficult position.").

113. Joyce, *supra* note 111.

114. Rosenberg, *supra* note 89, at 189.

115. Graeme S. Cooper, *Analyzing Corporate Tax Evasion*, 50 Tax L. Rev. 33, 100 (1994) (stating that business entities conceal tax-motivated transactions from auditors).

116. Joint Committee on Taxation, Study of Present Law Penalty and Interest Provisions, as Required by Section 3801 of the Internal Revenue Service Restructuring and Reform Act of 1998, JCS-3-99 (1999), at 212.

117. Between 2001 and 2006, the Service reported an increase in enforcement revenue of 40%, from $33.8 billion in 2001 to $48.7 billion in 2006. IR-News Rel. 2006-28 (2006); Joyce, *supra* note 111.

118. *See generally* IR-News Rel. 2006-28 (2006).

119. *See generally* Joyce, *supra* note 111.

120. Stephen Joyce, *TRAC Says IRS Spends Less Time on Audits: IRS Says Worker Gains Mean More Revenue*, Daily Tax Rep. (BNA), Dec. 21, 2006, at G-8.

121. David Cay Johnston, *Agents Say Fast Audits Hurt I.R.S.*, N.Y. Times, Jan. 12, 2007, at C1. One Service auditor referred to the practice as "catch and release," with agents being prevented from pursuing too diligently questionable corporate tax deductions. Subsequent to the *N.Y. Times* article, the Service established an internal website through which revenue agents may register complaints about Service management oversight of auditing

enforcement of tax laws in the form of *qui tam* actions can fill these gaps in public enforcement, and supplement public resources allocated to detecting and prosecuting abusive and illegal activity.

Qui tam actions might also help fill the "resource gap" currently separating tax regulators and private sector tax lawyers. In many respects, compared to the private tax bar, the Service is short personnel, money, and expertise.[122] The first two deficiencies go hand in hand. Between 1996 and 2003, funding for Service personnel resources fell dramatically, resulting in a 36% decline in combined collection and examination function enforcement staff.[123] During the same period, the number of revenue officers and revenue agents, two groups critical to detection and compliance efforts, declined by 40% and 50%, respectively.[124] Meanwhile, Service workload jumped sharply, with the number of taxpayers filing returns growing from 115 million in 1995 to 132 million in 2006.[125]

Shortfalls in expertise are harder to quantify. But anecdotal evidence suggests that this component of the resource gap is an even larger problem than personnel and funding issues.[126] One seasoned tax lawyer reported that in one of the biggest partnership tax cases of the last 20 years, the investigating revenue agent suspended the audit for several weeks toward the end of the inquiry to attend an entry-level partnership class. In another partnership investigation, a private-sector lawyer spent several hours trying to explain to the investigating agents that, as the agents *did* understand, reduction of debt inside a partnership is treated as a cash distribution[127] (which had not been reported as income by the partners in the case), but there was the offsetting fact that the debt also increased outside basis when it was first assumed by the partnership, so the distribution was not in excess of basis after all.[128] Once the agents understood that they had overlooked the effect of the debt on outside basis, they closed the case, but only after months of expensive, resource-intensive investigation. In addition, some practitioners report that 40% to 50% of issues on tax returns get picked up by revenue agents today, whereas of old that figure was closer to 70%

practices. *See* Stephen Joyce, *Everson Defends IRS Audit Practices, Use of Private Collection Agencies*, Daily Tax Rep. (BNA), Mar. 21, 2007, at G-6. For the Service's response to criticism of its large corporate audit program, see *Everson Responds to Doggett on IRS Corporate Audit Cycles*, 2007 Tax Notes Today 55-16 (Feb. 28, 2007).

122. David Schizer has drawn a similar conclusion. "In important respects, the private tax bar outmatches their counterparts in government. This imbalance is one of sheer numbers, of access to information, and, at least in some cases, of sophistication and expertise." David M. Schizer, *Enlisting the Tax Bar*, 59 Tax L. Rev. 331, 331 (2006).

123. Colleen M. Kelley, Internal Revenue Service Operations and the Tax Gap, Prepared Remarks Submitted to the House Ways and Means Subcommittee on Oversight, 07 No. 053 BNA Taxcore 018 (Mar. 20, 2007) (statement of Colleen M. Kelley, National Treasury Employees Union).

124. Diane Freda, *NTEU President Kelley Tells Congress More Workers Key to Reducing Tax Gap*, Daily Tax Rep. (BNA), Mar. 20, 2007, at G-6.

125. *Id.*

126. The "anecdotal evidence" was gathered from discussions with practitioners in the Los Angeles, New York, and Washington, DC, legal markets.

127. I.R.C. § 752(b).

128. I.R.C. § 752(a).

to 90%.[129] Professor John Braithwaite has reported a similarly dismal assessment of revenue agent competence among elite tax lawyers in the New York legal market. It is "not hard to get things by them," one of Braithwaite's interviewee's shared, while another opined, "The real issue is that the IRS aren't [sic] smart enough to find these [sophisticated tax shelter] deals on a tax return."[130] Finally, a recent national news story exposed in stark relief this purported "competence gap," a subset of the gaping resource gap that is currently undermining the government's tax enforcement efforts. The government successfully prosecuted the biggest tax fraud case in the nation's history only to botch the plea agreement, preventing it from collecting over $100 million in unpaid taxes.[131]

The Service has implemented aggressive measures to reduce the alleged competence gap. The initiatives of Chief Counsel Donald Korb are particularly laudable. For the last two years, Korb and his deputies have personally recruited at the nation's top law schools with an aggressive campaign dubbed, "Great Place to Start" and a glossy brochure that contains biographies of tax luminaries whose legal careers began at the Service.[132] Korb's stated message—in addition to recruiting top talent to the nation's largest tax law firm, the Chief Counsel's office—is to return "a healthy respect for the IRS."[133] By all accounts, the program has been incredibly successful. In both 2006 and 2007, the Chief Counsel's Office received over 3000 applications from law students, and it interviewed at more than 150 law schools, compared to only 60 law schools in 2005.[134]

While these recent efforts are undoubtedly necessary to generate respect for the Service and to populate Service enforcement personnel with talented attorneys, they are not sufficient. For one thing, the Chief Counsel Office's recruiting efforts do not address the deficiencies in expertise among revenue agents or federal prosecutors. More drastic measures need to be considered, including the recommendations offered by David Schizer, Dean of Columbia Law School. With respect to increasing government expertise as part of the effort to combat overaggressive tax reporting and sheltering, Schizer proposes recruiting senior

129. *See supra* note 126.

130. John Braithwaite, Markets in Vice, Markets in Virtue 133 (2005).

131. Eccentric telecommunications mogul Walter C. Anderson received a nine-year prison term in March 2007, but he escaped paying restitution because federal prosecutors mistakenly listed the wrong statute in the agreement. *See* Jeremiah Coder, *Justice Dept. Loses Again in Tax Fraud Collection Case*, 115 Tax Notes (TA) 1260 (June 26, 2007); Carol D. Leonnig, *Prosecutors' Slip Keeps Money in Limbo; Court Refuses Restitution Order for Mogul, Says Plea Deal Cites Incorrect Law*, Wash. Post, Mar. 29, 2007, at B06.

132. Robert Guy Matthews, *It's Taxing to Recruit Top Law Grads to IRS, But a New Push Betters Returns*, Wall St. J., Oct. 10, 2006, at B1; Sheryl Stratton, *After One Year on the Job, IRS Chief Counsel Reviews, Previews*, 107 Tax Notes (TA) 292, 292 (Apr. 18, 2005). For the brochure, see http://taxprof.typepad.com/taxprof_blog/files/publication_4063.pdf. The tax luminaries include Sheldon Cohen (former Service Chief Counsel and Commissioner of Internal Revenue), Pamela Olson (former Assistant Secretary of the Treasury for Tax Policy), and Ronald Pearlman (former Assistant Secretary).

133. Quoted in Alison Bennett, *Korb Defends Aggressive Shelter Approach; Vows to Help Efforts to Reach 'Equilibrium,'* 198 Daily Tax Rep. (BNA), Oct. 13, 2006, at G-1.

134. Telephone Interview with Hsinyu Yu, Attorney Recruitment Manager, IRS Chief Counsel Office (Jan. 30, 2008).

private practice tax attorneys out of retirement to mentor recent law school graduates entering government work, adopting a generous loan forgiveness program for these graduates, and retaining expert academics and private law firms to litigate important tax controversies.[135]

Even with the smartest, best educated, highest paid personnel, the Service would still be at a disadvantage. Staffing and retention are problems for the Service, but skill level is not the primary issue. Indeed, in many respects, the "information gap" separating tax regulators from private sector tax lawyers is significantly wider than the resource gap. Service enforcement is so severely handicapped by informational asymmetries that taxpayers can engage in abusive tax planning, accurately report transactions associated with that planning, yet still provide the Service no indication that abusive activity may have taken place.[136]

Qui tam for tax could level the compliance playing field by mitigating these resource and information gaps. Aligning the interests of taxpayers, tax practitioners, and tax regulators by providing economic incentives for exposing abusive taxpayer behavior would put taxpayers on the enforcement side of the tax avoidance game. In addition, would-be *qui tam* plaintiffs would need to consult private practitioners respecting the information they possess and how they should interact with the government, particularly the new Service Whistleblower Office. In the event the government decided not to prosecute the case based on an informant's information, but allowed the informant to proceed as a *qui tam* plaintiff, the informant would need legal representation. In this way, *qui tam* for tax might also encourage private sector tax lawyers to align on the side of tax collection rather than tax avoidance. In fact, since passage of the 2006 amendments to the tax whistleblower statute, the tax whistleblower bar has grown perceptibly, as much as 15% to 20% according to the national organization of *qui tam* lawyers.[137] The influx of private sector tax attorneys to *qui tam* practice

135. Schizer, *supra* note 122, at 333, 346–52. The government may not even have to pay top dollar for these services. According to interviews conducted by sociologist John Braithwaite, elite New York tax attorneys seemed "almost itching at the thought of being invited to serve in a senior capacity at the IRS." Braithwaite, *supra* note 130, at 133. For those attorneys requiring economic incentives to assist tax officials, Professor Rosenberg has recommended a bounty program that would pay practitioners cash for alerting the government to legal uncertainties and undiscovered tax avoidance schemes. Rosenberg, *supra* note 89, at 224–26.

136. Consider the intermediary transaction tax shelter, typically involving four parties: a seller (S) who wants to sell the stock of a target corporation (T); a promoter-controlled intermediary entity (E); and a buyer (B) who wants to purchase the assets but not the stock of the target. Under the terms of a pre-arranged plan, S purports to sell the stock of T to E. E has arranged financing for the sale through a bridge loan, which is secured by the assets of T. At the same time or shortly after the stock sale, E purports to sell T's assets to B. The bridge loan is repaid from the proceeds, while any excess proceeds are retained by E, essentially as a fee for serving as the accommodation party. As a result of the transaction, S recognizes reduced gain due to its high basis in the stock of T; B receives larger depreciation and amortization deductions based on the fair market value of the assets (rather than taking T's basis in the assets); and E avoids paying tax on the gain from the asset sale by offsetting the gain with losses from the sale of inflated-basis assets. As far as the Service is concerned, S's tax return reflects a simple sale, while B's reflects a straight asset purchase. The only way for the Service to expose the scheme is to examine the returns of all four parties and nail the promoter. *See* Notice 2001-16, 2001-9 I.R.B. 730. I am grateful to William Alexander for this example of information asymmetries.

137. Telephone Interview with Jeb White, Editor, *Quarterly Review*, the official publication of Taxpayers Against Fraud (TAF), (July 3, 2007).

increases the number of tax advisors available to assist *qui tam* plaintiffs, as well as tax officials, in collecting unpaid taxes.

Perhaps most importantly, the threat of *qui tam* actions could alter governance and compliance norms *within* organizations, and deter noncompliant behavior at the source. The threat of *qui tam* litigation, the promise of bounties, and improved protections for whistleblowers[138] could strongly encourage insider-informants to expose noncompliance. This private enforcement of tax law can provide a particularly efficient form of regulation. Modern economic theory suggests that it is appropriate and often optimal for regulators to shift the cost of compliance to the party or parties with the lower cost of monitoring.[139] In many instances, that party is the outside tax professional or compliance counselor within regulated entities, both of whom often possess intimate knowledge of potentially noncompliant activity. "The chief virtue of private monitoring," Kovacic has observed, "is that it gives monitoring tasks to individuals closest to the relevant information."[140] Those individuals are in a unique position to deter and detect noncompliant behavior. To the extent tax professionals advise reporting positions and transactions, or are themselves the decision makers within organizations,[141] the threat of whistleblower actions and subsequent *qui tam* litigation might make them think twice before advising or endorsing impermissible or likely impermissible activity. Furthermore, as the last section of this Article demonstrates, these tax professionals may already be obligated to disclose insider information pertaining to tax violations, even purportedly privileged information, under federal securities laws.

VI. FINE-TUNING *QUI TAM* FOR TAX WHISTLEBLOWERS

It remains to be seen whether an enhanced whistleblower statute will prove as effective an enforcement mechanism for tax as it has proven for other areas of the law. In particular, it is unclear whether allowing private persons to bring *qui tam* actions in the event the government decides not to prosecute an alleged tax violation will provide marginal benefits beyond the existing bounty system. Indeed, this Article has argued that extending *qui tam* to tax would not induce

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138. *See infra* notes 157–72 and accompanying text.

139. *See, e.g.*, Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. Legal Stud. 1, 1-15 (1974) (concluding that private enforcement of public laws can be more efficient than public enforcement). For a more recent discussion in the context of antitrust regulation, see Jonathan B. Baker, *Antitrust in the 1990s*, *in* FTC History: Bureau of Economics, Contributions to Law Enforcement, Research, and Economic Knowledge and Policy (2003), *available at* http://www.ftc.gov/be/workshops/directorsconference/docs/directorstableGOOD.pdf#page=136.

140. Kovacic, *supra* note 37, at 774.

141. Susan Morse has shown that changes in substantive regulation and disclosure requirements—including internal controls imposed by Sarbanes-Oxley and heightened opinion standards imposed by Circular 230—have had a positive impact on tax compliance norms shared by tax decision-makers at large public corporations. These norms have produced "general liability concerns within organizations, including the corporate taxpayer itself, accounting firms, and other advisors to which members of the tax decision-making group belong." Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 Fordham L. Rev. 961, 964 (2006).

frivolous claims on grounds that, among other things, the low expected financial payouts in the FCA context associated with prosecuting *qui tam* actions when the government decides not to pursue a *qui tam* claim might provide insufficient incentives for individuals to bring such actions.[142] Assuming similarly low recovery percentages for *qui tam* plaintiffs in the tax context, it is fair to ask whether adding a few more successful whistleblowers is worth the trouble of providing a *qui tam* element to the tax whistleblower statute. In some respects, the current bounty system may encourage *more* whistleblowers to come forward than a *qui tam* system, because the procedures of a bounty system are less onerous; whistleblowers can simply submit a claim to the Service, for instance, while *qui tam* plaintiffs typically must hire a lawyer to initiate proceedings.

Though the ultimate benefits of extending *qui tam* to tax are uncertain, the existing evidence suggests that adding a *qui tam* provision to the tax whistleblower statute would deter noncompliance and enhance enforcement. First, as discussed above, the threat of *qui tam* lawsuits adds real as well as perceived risk to the compliance calculus.[143] It increases the probability of detection and subsequent prosecution, which researchers have shown corresponds particularly strongly with increased tax compliance.[144] Second, if the government publicizes the threat of *qui tam* lawsuits and the successful prosecution of tax cheats, research also indicates that such publicity could discourage noncompliant behavior and at the same time reinforce compliant behavior.[145] Third, the *qui tam* approach might actually encourage more private persons to come forward with information of wrongdoing than a pure bounty system for two additional reasons: some would-be informants might be comforted knowing that the federal government will help prosecute the lawsuit they initiate, while other informants might be comforted knowing that they will have an opportunity to proceed with the action on their own if the government does not act on what the informant believes to be unique and important information. Fourth, the mixture of bounties and *qui tam* lawsuits seems to be working effectively in the FCA context,[146] and the foregoing discussion indicates that the same mixture could work even more effectively in the tax context. Finally, the *qui tam* approach bridges private and public enforcement of the law, thereby reconceptualizing the law and its enforcement as a civic obligation not only of public officials but also of private persons. In this way, it recruits private citizens into the government's enforcement efforts, and provides tax officials with valuable information to detect otherwise undiscovered tax cheating.

Whether Congress decides to rely exclusively on a bounty system for the Service whistleblower statute or to embrace a complementary *qui tam* approach, policymakers will encounter a number of difficult implementation issues, in-

142. *See supra* notes 107–08 and accompanying text.

143. *See supra* notes 109–10 and accompanying text.

144. *Id.*

145. *See supra* notes 96–97 and accompanying text.

146. *See supra* notes 61–84 and accompanying text.

cluding (1) taxpayer privacy; (2) the potential for frivolous and harassing claims; (3) inadequate protections for whistleblowers; (4) informants connected to the underlying abusive behavior; and (5) jurisdictional competence and inefficiencies. This Part offers recommendations for addressing these issues.

A. Taxpayer Privacy and Frivolous Claims

Critics of the tax whistleblower statute have argued that it infringes on taxpayer rights. Informants can allege wrongdoing with little or no evidence, use the statute as a way to carry out personal vendettas, and impose "tremendous costs" on taxpayers under investigation by the Whistleblower Office.[147] Moreover, critics have expressed concern that when an award is made to a former employee of a particular company that disclosed in its reporting materials a tax penalty for the period related to the award, it might be possible to connect the dots, and identify the informant by linking the award and the penalty.[148]

These concerns over taxpayer harassment and privacy are grossly overblown. With respect to privacy concerns, current regulations prohibit disclosure of an informant's identity, even after the case is closed and the Service has paid the bounty.[149] Thus, unless someone affirmatively breaks the law by revealing the identity of an informant, "connecting the dots" would be a very difficult endeavor. Moreover, if a private citizen prosecutes the action after the government has declined to proceed, she can sue anonymously under a pseudonym to avoid revealing her identity. To the extent privacy concerns extend to *qui tam* taxpayers rather than *qui tam* plaintiffs, Congress might very well be in the mood to relax section 6103 prohibitions against disclosure of tax return information, as discussed above.[150]

Respecting harassment concerns, Director Whitlock has stated explicitly that his office will develop "'a positive message' about the program in order to instigate cases with merit without compelling citizens to make personal or vindictive claims."[151] In addition, the Service has said it wants the Whistleblower Office to concentrate on large-dollar cases.[152] The recent amendments to section 7623 limit claims to cases against taxpayers whose gross annual income exceeds $200,000 and whose potential indebtedness for taxes, penalties, and interest

147. *See, e.g.*, Allen Kenney, *Critics Question Whistleblower Proposal in Senate ETI Bill*, 104 Tax Notes (TA) 111, 112 (July 12, 2004) (quoting former Assistant Secretary for Tax Policy Pamela Olson).

148. *See, e.g.*, Stephen Joyce, *IRS Working on Whistleblower Office Rules; Issues Include Confidentiality, Award Process*, Daily Tax Rep. (BNA), May 15, 2007, at G-2. While there may be a good argument for wanting to hold a *qui tam* taxpayer accountable for wrongdoing, and even publicizing that wrongdoing, we might be less enthusiastic in cases involving settlements, particularly for small sums of money, rather than judgments.

149. *See* Reg. § 301.7623-1(e) ("No unauthorized person will be advised of the identity of an informant."); *see also* I.R.C. § 6103(i)(6) (stating that "the Secretary shall not disclose any return or return information . . . if . . . such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.").

150. *See supra* notes 91–95 and accompanying text.

151. Joyce, *supra* note 60.

152. *See* Joyce, *supra* note 148 (quoting Director Whitlock as saying that the Whistleblower Office will focus on large-dollar cases).

exceeds $2,000,000.[153] Therefore, while there is nothing to prevent informants from bringing vindictive or spiteful whistleblower claims, the dollar limitations shrink considerably the potential universe of such actions. Moreover, the enhanced whistleblower law could be amended still further to include sanctions for frivolous claims. The False Claims Act provides that a defendant may be awarded "reasonable attorneys' fees and expenses if the defendant prevails in the action and the court finds that the claim was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[154] If we are still worried about harassing claims, particularly in the early stages of the new program where informants might try to cash in by exposing past abuses, the Whistleblower Office could allow for a period of amnesty, whereby *qui tam* taxpayers pay tax and interest due without penalty. Recent experience with amnesty programs and settlement initiatives has been quite successful in prompting tax evaders to come forward, cut their losses, and pay tax owed.[155] Moreover, amnesty programs have been shown to increase long-term compliance by bringing people onto the tax rolls, and identifying continuing sources of previously unreported income.[156]

B. Whistleblower Protections

While some criticism of the enhanced tax whistleblower statute concerns the treatment of *qui tam* taxpayers, other criticism involves the treatment of *qui tam* plaintiffs. The recent amendments to section 7623 added significant monetary incentives for tax whistleblowers to come forward, but they failed to provide adequate protections for those informants. Larger awards might compensate the informant for risking investment in her career and standing in her community of peers, but not against retaliatory actions on behalf of employers or colleagues. The False Claims Act addresses this problem by providing safeguards for employees who are punished by employers because of the employee's lawful acts in investigating, initiating, testifying, and otherwise assisting in a *qui tam* action. In particular, under the FCA, the aggrieved employee may obtain "all relief necessary to make the employee whole," including restoring seniority, two times

153. I.R.C. § 7623(b)(5). But see legislative efforts to decrease that amount to $20,000, which supporters have advocated as a revenue raising measure. Fair Minimum Wage Act of 2007, H.R. 2, 110th Cong. § 233 (2007) (as passed by House on January 20, 2007 and as passed by Senate on February 1, 2007). The Service has opposed efforts to lower the monetary thresholds. *See* Joyce, *supra* note 148 (quoting Director Whitlock as saying that a lower threshold could create a "significant problem" for the current policy of concentrating on large-dollar cases); Joyce, *supra* note 60 (reporting Service officials as wanting to keep the monetary threshold at $2,000,000 to avoid the submission of "weak claims and vindictive cases among neighbors"). For additional commentary on the pros and cons of eliminating the monetary thresholds, see Todd Simmens, *Proposed Whistle-Blower Reforms: Not Ready for Prime Time*, 105 Tax Notes (TA) 743, 743–44 (Nov. 1, 2004).

154. 31 U.S.C. § 3730 (2003).

155. The Service has had particular success with amnesty programs and global settlements associated with some of the most notorious tax shelters. *See, e.g.*, Stephen Joyce, *About 2,000 Taxpayers to Pay $2 Billion in Global Settlement, Everson Says*, Daily Tax Rep. (BNA), Mar. 28, 2006, at G-2; IR-News Rel. 2005-72.

156. *See, e.g.*, Ronald C. Fisher, John H. Goddeeris & James C. Young, *Participation in Tax Amnesties: The Individual Income Tax*, 42 Nat'l Tax J. 15, 19 (1989). Amnesty programs are less effective when taxpayers perceive that they will be followed by lax enforcement of the law. *See id.*

back pay, interest on back pay, special damages, litigation costs, and reasonable attorneys' fees.[157]

Federal securities law offers stronger whistleblower protections that might serve as a model for improving the Service whistleblower statute. Section 806 of the Sarbanes-Oxley Act[158] created a new federal cause of action, "Whistleblower Protection for Employees of Publicly Traded Companies," designed to protect whistleblowers from retaliation by employers for providing information on violations of federal securities law, the SEC rules, or "any Federal law relating to fraud against shareholders."[159] Under the statute, a protected employee cannot be discharged, demoted, suspended, threatened, harassed, or discriminated against due to a protected disclosure.[160] Employees that encounter employer retaliation for covered disclosures are entitled to "all relief necessary to make the employee whole," including immediate reinstatement to the same seniority status that the employee would have had but for the adverse employment action; back pay; interest; and "special damages" such as litigation costs, expert witness fees, and reasonable attorney fees.[161] Section 1107 of Sarbanes-Oxley offers whistleblower protection to employees of public as well as private companies for disclosures related to the purported commission of *any* federal offense.[162] Employers found to have violated section 1107 of Sarbanes-Oxley are subject to fines and up to ten years in prison.[163]

Though sections 806 and 1107 of Sarbanes-Oxley, as written, extend powerful protections to corporate whistleblowers, as implemented, the sections have largely failed to protect informants. For instance, it appears that the criminal provision, section 1107, has yet to be used by the Department of Justice.[164] In addition, of the nearly 1,000 complaints filed under section 806 between the enactment of Sarbanes-Oxley and June 2007, not a single complaint ended with the whistleblower prevailing. In total, 947 whistleblower cases were filed with the Department of Labor's (DOL) Occupational Safety and Health Administration, the agency charged with administering the majority of federal whistleblower laws.[165] The DOL dismissed 665 of those complaints as having no merit,

157. 31 U.S.C. § 3730(h) (2000).

158. *Id.*

159. Pub. L. No. 170-204, § 806(a), 116 Stat. 745, 802–03 (codified at 18 U.S.C. § 1514A(a)(1) (Supp. 2003)).

160. *Id.* § 1514A(a).

161. *Id.* § 1514A(c).

162. *Id.* § 1513(e). The flush language of the statute, codified as part of the federal criminal code prohibiting retaliation against witnesses, victims, or informants, reads:

> Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

Id.

163. *Id.*

164. Email from Richard Moberly to Dennis Ventry (July 20, 2007) (on file with author).

165. Tim Reason & Stephen Taub, *Whistle-blowers Never Win*, CFO.com (June 8, 2007), *available at* http://

while another 138 were settled before the DOL could rule on them, and 126 were withdrawn by the complainant (and presumably settled).[166] Only 17 cases made it through the first level of DOL review, and only six whistleblowers prevailed on the merits at the second level of review (the DOL's administrative law judges).[167] Of those six cases (just 0.7% of all complaints filed under section 806), three were reversed at the final level of review, the DOL's Administrative Review Board, and of the remaining three cases, two settled and one remains open.[168]

Professor Richard Moberly has examined in rich detail the low rate at which whistleblowers currently prevail under Sarbanes-Oxley protections. After looking at every case filed under section 806, Moberly concludes that administrative decisionmakers at the DOL have strictly construed and even misapplied the protections to the disadvantage of employee-whistleblowers.[169] Moberly also suggests several ways to improve Sarbanes-Oxley's anti-retaliation provisions, such as making procedural and interpretive clarifications to assist the DOL in the appeals process, and expanding the Act's whistleblower protections to private as well as public companies and to disclosures pertaining to *any* unlawful activity rather than simply to corporate fraud.[170] To the extent Congress or tax officials rely on Sarbanes-Oxley whistleblower protections as a model for an enhanced tax whistleblower statute, they will need to be wary of the difficulties of translating "the idealistic legislative goal of broad employee protection into realistic rights and attainable remedies."[171] Other scholars have noted that

www.cfo.com/article.cfm/9321686?f=related (reporting on a study published by the law firm Orrick, Herrington & Sutcliffe, LLP). For an earlier report with equally depressing figures, see Kathleen Day, *Whistle-Stop Campaigns: Some Firms Are Trying to Limit Protection of Workers Who Expose Wrongdoing*, Wash. Post, Apr. 23, 2006, at F1.

166. Reason & Taub, *supra* note 165. Of the settled cases, several have pertained to employees whose whistleblowing involved tax matters. One particularly high-profile case involved Michael Hamersley, a former senior manager and tax lawyer at the accounting firm, KPMG, who alleged that he was put on administrative leave after refusing to sign off on questionable tax shelters sold to an audit client. *See* Request for Dismissal, Hamersley v. KPMG LLP (Cal. Jan. 8, 2004) (No. BC297905) (settling in 2004 for an undisclosed amount). For a more detailed account of the circumstances surrounding Mr. Hamersley's lawsuit, see Tanina Rostain, *Travails in Tax: KPMG and the Tax Shelter Controversy*, *in* Legal Ethics Stories 89 (Deborah L. Rhode & David Luban eds. 2006). For another, still unresolved, case involving tax whistleblowers and the Sarbanes-Oxley protections, see generally Schmidt v. Levi Strauss & Co., No. 419398, 2004 WL 2418291 (Cal. Ct. App. 2004) (a suit against Levi Strauss & Co. by two former in-house tax directors of the company who alleged retaliation for blowing the whistle on purported falsification of financial statements). *See also* Sally Beatty & Glenn R. Simpson, *Levi Again Hires Counsel to Review Tax Accounting*, Wall St. J., June 2, 2003, at A-3.

167. Reason & Taub, *supra* note 165.

168. *Id.*

169. Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 Wm. & Mary L. Rev. 65, 67-68 (2007). For additional criticism of inadequate protections for whistleblowers under Sarbanes-Oxley, see Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 Mich. L. Rev. 1757 (2007); Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. Rev. 1107 (2006). The phenomenally low rates of vindication for whistleblower claims might have more to do with the high frequency of frivolous claims than with the government's lack of commitment to enforcing the provision in the employee's favor. Discussions with defense lawyers in several legal markets revealed a firm belief that the first thing managers do when they are about to be terminated for cause is to manufacture bogus whistleblower allegations. *See supra* note 126.

170. Moberly, *Unfulfilled Expectations*, *supra* note 169, at 134–52.

171. *Id.* at 74.

under-enforcement of the whistleblower provisions undermines Congress's desire to encourage private individuals to expose corporate wrongdoing. To provide additional incentives to counteract the shortcomings of Sarbanes-Oxley's anti-retaliation features, some of these scholars recommend adopting a *qui tam* bounty approach for the securities and corporate fraud context.[172] These proposals parallel those contained in this Article, and argue that a mixture of bounties and *qui tam* lawsuits provide strong incentives for private enforcement of public laws, which, going forward, could deter noncompliant behavior and at the same time encourage compliant behavior.

C. "Connected" Informants and Streamlining Jurisdiction Over Tax Whistleblowers

In addition to offering adequate protections for informants, the amended tax whistleblower statute will also have to adopt procedures for dealing with informants connected to the underlying abusive behavior providing the basis for a cause of action. Section 7623(b)(3) offers some guidance, stating that the Whistleblower Office "may appropriately reduce [an] award" if it finds that the informant "planned and initiated" the actions underlying the award claim.[173] The office may also deny a claim altogether if the informant is convicted of criminal conduct associated with the planning or initiating of the actions giving rise to the award claim.[174] In this respect, the tax whistleblower statute reflects the False Claims Act, which cuts off recoveries by persons who participate in the challenged misconduct. The FCA whistleblower receives nothing if she is convicted of criminal conduct that also violates the FCA. If there is no criminal conviction, the court may reduce the bounty of a whistleblower who plans and initiates the violations, but must account for the person's role "in advancing the case to litigation and any relevant circumstances pertaining to the violation."[175] Neither whistleblower statute is particularly helpful on its face, however, and both require interpretation with respect to the treatment of interested or conflicted informants. In the case of the FCA, the district courts have accumulated considerable experience with evaluating award determinations.[176] They also have experience handling inappropriate claims filed for purposes of harassment or delay, as well as leveling sanctions against abusive *qui tam* informants.[177] Un-

172. *See* Dworkin, *supra* note 169, at 1769–71; Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. Rev. 91, 126–34 (2007); Moberly, *Sarbanes-Oxley's Structural Model*, *supra* note 169, at 1108 n.5.

173. I.R.C. § 7623(b)(3).

174. I.R.C. § 7623(b)(3). For a discussion of these issues among officials and practitioners, see Joyce, *supra* note 148, at G-2.

175. 31 U.S.C. § 3730(d)(3) (2000).

176. Recall that 31 U.S.C. § 3732 places jurisdiction for FCA claims in the district court in which the defendant resides, transacts business, or in which any alleged violation occurred. And, as Todd Simmens has pointed out, district courts, concurrent with the Court of Federal Claims, "generally hear cases involving monetary claims against the United States or against taxpayers." Simmens, *supra* note 153, at 744. *See* I.R.C. §§ 7402–7405; 28 U.S.C. §§ 1346, 1491.

177. *See* Simmens, *supra* note 153, at 744.

fortunately, the current tax whistleblower statute requires informants to appeal Service award determinations to the United States Tax Court,[178] a tribunal considerably less experienced in these matters than district courts. To remedy this shortcoming of the tax whistleblower statute and to help the Service determine what to do with interested informants, Congress could provide jurisdiction for review of whistleblower award determinations in the district courts alone or concurrent with the tax court.

VII. DUTY TO PROTECT VERSUS DUTY TO DISCLOSE

The most difficult issue confronting proponents of an invigorated tax whistleblower law involves potential violations of professional confidentiality. By paying valuable awards to informants, the enhanced statute could create a conflict for an attorney, pitting her ethical obligation to uphold client confidences against the legislatively authorized incentive to expose her client's purported tax violations. While the new tax whistleblower law and this Article's recommendation to extend *qui tam* to tax raise issues of confidentiality for tax professionals, federal law already requires tax advisors in certain situations to disclose client communications associated with tax violations. In particular, securities law imposes a compulsory whistleblower requirement on lawyers with knowledge of, among other things, material violations of federal or state tax laws.[179] In addition, recent changes to standards of tax practice promulgated by the Treasury Department impose on tax practitioners new disclosure requirements, and further deputize tax advisors in the government's longstanding effort to crack down on tax avoidance.[180] Moreover, Congress, the courts, and the Department of Justice continue to extend protections to lawyers as well as non-lawyers acting under federal whistleblower laws, even if state law obligations of confidentiality otherwise restrict those individuals from sharing client or employer communications.[181] The recommendations contained in this Article for fine-tuning the tax whistleblower statute and extending *qui tam* to tax reinforce a powerful trend that encourages private enforcement of public law, and protects informants from disclosing violations of law or public policy, even when disclosure conflicts with private law obligations.

A. Muffling the Whistleblower: The Duty to Protect Confidential Information

Tax practitioners have expressed particular concern over the potentially perverse incentives of the tax whistleblower program on client confidentiality. Even before the recent amendments added heightened monetary incentives to blow

178. I.R.C. § 7623(b)(4).

179. *See infra* notes 214–23 and accompanying text.

180. *See infra* notes 252–55 and accompanying text.

181. *See infra* notes 256–57, 259–61 and accompanying text.

the whistle on tax cheats, including clients, some practitioners argued that "voluntarily disclosing information regarding a client or former client would violate the professional standards of the CPA or the attorney and could well lead to loss of professional status. Yet there may be money to be made" under the whistleblower statute, accountants Burgess and William Raby warned, "and perhaps grudges to be settled or professional judgments to be vindicated, on rare occasions."[182] In those damage situations, Raby and Raby noted that alternative remedies exist, "but they no more should involve turning informer than they should involve taking a sledgehammer to the offender's automobile or inflicting bodily harm on him or her."[183] Although the analogy strains symmetry, the fact remains that under some circumstances attorneys and accountants may violate professional obligations in the event they voluntarily disclose information regarding a client or former client even if that disclosure exposes a violation of the tax law leading to its successful prosecution.

Disclosure of confidential information under the tax whistleblower statute could result in other adverse consequences for the tax professional. For example, attorneys and accountants can expose themselves to potential tort liability for sharing confidential client communications, as well as to breach of contract claims to the extent the engagement includes an enforceable confidentiality agreement. In addition, section 7216 makes it a misdemeanor for a tax practitioner to "knowingly or recklessly" disclose any information furnished in connection with the preparation of tax returns, or to use such information for any other purpose.[184] Moreover, Circular 230, the Treasury regulations governing standards of tax practice,[185] does not obligate the tax practitioner to notify the Service in the event of a discovered error on a previously filed return; the practitioner need only notify her taxpayer-client, at which point, she has fulfilled her professional duties. Furthermore, if the practitioner is an accountant, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct mandates that a CPA "in public practice shall not disclose any confidential client information without the specific consent of the client."[186] If the practitioner is an attorney, the ABA Model Rules of Professional Conduct similarly prohibit her from revealing information related to the representation of a client without the client's informed consent.[187] In the absence of such consent, the attorney can reveal client confidences only to prevent reasonably certain death or substantial bodily harm,[188] to prevent the client from committing

182. Burgess J.W. Raby & William L. Raby, *The Tax Practitioner as Tax Informer*, 2000 Tax Notes Today 230-14 (Nov. 29, 2000).

183. *Id.*

184. I.R.C. § 7216(a).

185. *See* 31 C.F.R. pt. 10 (2007) [hereinafter Circular 230]. Circular 230 regulations govern tax practice "before the IRS," which is read broadly to include all written tax advice, from planning to litigation.

186. AICPA Code of Prof'l Conduct R. 301 (1992), *available at* http://www.aicpa.org/about/code/et_300.html#et_301.

187. *See* Model Rules of Prof'l Conduct R. 1.6 (2003).

188. *Id.* R. 1.6(b)(1).

a crime or fraud,[189] or to rectify or mitigate losses suffered at the hands of a client's criminal activity or fraud.[190] If the client is an organization rather than an individual, the Model Rules permit the attorney to reveal information relating to the representation but only if the information pertains to a violation of a legal obligation to the organization or a violation of law that could reasonably be imputed to the organization, and even then only if the attorney has exhausted all internal procedures for reviewing the violation, and believes with reasonable certainty that the violation will cause substantial injury to the organization.[191] Under extreme circumstances, the attorney can withdraw from the representation, but permissible withdrawal includes protecting client confidences.[192]

In sum, if a practitioner blows the whistle on her client or former client and in the process reveals information related to the representation of that client, the practitioner could be subject to liability under tort law, contract law,[193] and the Code.[194] She could also be subject to discipline under her licensing body for violating rules of professional conduct, and she could lose her license to practice either as an attorney or an accountant.[195]

Given these dire consequences to personal financial well-being and professional status, it is uncertain whether the monetary awards associated with the revamped tax whistleblower statute provide enough incentive for practitioners to expose client confidences. A tax practitioner may be in a good position to detect underpayments of tax or other violations of the tax laws, and the government might be willing to pay substantial sums of money for such information. But if the information is related to the representation of a client, and the practitioner turns it over to the government, the potential whistleblower award (the receipt of which is hardly certain) might not cover the practitioner's subsequent financial losses. Recall that a tax whistleblower can receive, at most, 30% of the collected proceeds resulting from the legal action based on the informant's information or from settlement of such action.[196] In the event the client sues the practitioner under tort or contract theories, the damages sought would presumably equal or exceed the amount of total collected proceeds, a figure several multiples larger than any potential whistleblower award, which might not even be forthcoming given the above discussion of reduction and denial of awards.[197]

189. *Id.* R. 1.6(b)(2).

190. *Id.* R. 1.6(b)(3).

191. *Id.* R. 1.13(b) and (c).

192. *Id.* R. 1.16.

193. This assumes the existence of an enforceable confidentiality agreement. *But see infra* notes 259–61 and accompanying text.

194. *But see infra* notes 208–09 and accompanying text.

195. For a fuller discussion of the issues pertaining to accountants, see Raby and Raby, *supra* note 182.

196. I.R.C. § 7623(b)(1).

197. *See supra* notes 30–31 and 40–47 and accompanying text. Interestingly, the damages claimed would reflect the client's or employer's illegally avoided obligations plus interest and penalties on those evaded liabilities. It is hard to imagine that such a plaintiff would prevail in such a lawsuit, because the state law right of action would effectively make the plaintiff whole for violating federal tax law, thereby raising issues of preemption or at least a situation where the result was contrary to established public policy.

Thus, to the extent the new whistleblower law provides economic incentives for practitioners to turn over client information to the government, those incentives could be outweighed by the disincentives to share such information.

B. Enabling the Whistleblower: Sarbanes-Oxley and the Federal Regulation of Lawyers

Professional obligations of confidentiality are not as definitive or unyielding as they first appear. Nor are the circumstances under which a lawyer is permitted to share client confidences.[198] In addition, the obligation of tax professionals to protect client communications is increasingly ambiguous in many circumstances. What are the ethical obligations of lawyers and accountants, for instance, who are licensed but not active? Consider the licensed though inactive CPA working in-house and under the supervision of another licensed but fully active CPA or lawyer who signs off on all the company's documents. Can the inactive CPA share client information if she has knowledge of wrongdoing? Can the inactive lawyer, assuming she is not engaged in the unauthorized practice of law?[199] In addition, under the AICPA Rules of Conduct, a CPA "in public practice shall not disclose any confidential client information without the specific consent of the client."[200] But what about a member not in public practice, such as an in-house accountant? Consider, too, the Code's provision relating to confidentiality privileges and taxpayer information. Congress originally conceived section 7525,[201] enacted in 1998, as equivalent to the common law attorney-client privilege and applicable to all "federally authorized practitioners."[202] The provision protects communications pertaining to tax advice between a client and her tax adviser when those communications would have been considered privileged if between a taxpayer and her attorney.[203] However, over a very short period during which time Congress was responding to egregious corporate accounting scandals, the privilege was narrowed considerably by both the courts and the Service,[204] such that it effectively does not protect from disclosure, among other

198. "Few problems are as vexing," the federal court in the Eastern District of Virginia has opined, "as determining what evidence justifies a lawyer's disclosure of a client's confidential information and documents, which the lawyer believes reflect an ongoing or future crime or fraud," the classic exception to the attorney-client privilege. X Corp. v. Doe, 805 F. Supp. 1298, 1300 (E.D. Va. 1992), *aff'd*, Under Seal v. Under Seal, 17 F.3d 1435 (4th Cir. 1994).

199. *See* Model Rules of Prof'l Conduct R. 5.5 (2003).

200. *Supra* note 186 and accompanying text.

201. I.R.C. § 7525.

202. I.R.C. § 7525(a)(1). Section 7525(a)(3)(A) defines "federally authorized practitioner" according to Circular 230, which, in turn, defines the category to include attorneys, certified public accountants, enrolled agents, and enrolled actuaries.

203. *Id.* § 7525(a)(1).

204. *See, e.g.*, Danielle M. Smith & David L. Kleinman, *What Remains of the Federal Tax Practitioner Privilege Established Under Internal Revenue Code Section 7525?*, Daily Tax Rep. (BNA), June 9, 2006, at J-1; Amandeep S. Grewal, *Selective Waiver and the Tax Practitioner Privilege*, 112 Tax Notes (TA) 1139 (Sept. 25, 2006); Sheryl Stratton, *Lawyers Discuss Postshelter Assault on Privilege*, 107 Tax Notes (TA) 289 (Apr. 18, 2005).

things, the identity of a taxpayer,[205] tax practitioner work product,[206] or non-tax proceedings.[207] Finally, recall that section 7216 prohibits a tax practitioner from "knowingly or recklessly" disclosing any information furnished in connection with the preparation of tax returns, or from using such information for any other purpose.[208] However, the statute also contains an exception for disclosures made "pursuant to any other provision of this title,"[209] including the tax whistle-blower statute, section 7623.

Courts have even opined that the value of publicly disclosing private information can outweigh an attorney's confidentiality obligations. A lawyer's duty of confidentiality, for example, does not prevent her from bringing a *qui tam* action against a former client under the False Claims Act.[210] That is not the same thing as saying the FCA authorizes an attorney to disclose freely client confidences in bringing a *qui tam* action. And in fact, professional obligations of client confidentiality may have the effect of preventing disclosure in most circumstances. But if the attorney can overcome the various confidentiality duties (including the evidentiary attorney-client obligation,[211] which provides a crime-fraud ex-

205. *See* United States v. BDO Seidman, 337 F.3d 802 (7th Cir. 2003).

206. *See* United States v. KPMG, 237 F. Supp. 2d 35, 39 (D.D.C. 2002); United States v. Frederick, 182 F.3d 496, 502 (7th Cir. 1999) (stating in *dicta* that section 7525 "does not protect work product").

207. *See* Chao v. Koresko, 2005 U.S. App. LEXIS 22025 (3d Cir. 2005); Doe v. Wachovia Corp., 268 F. Supp. 2d 627, 637 (W.D.N.C. 2003).

208. *Supra* note 184 and accompanying text.

209. I.R.C. § 7216(b)(1)(A).

210. Doe v. X Corp., 862 F. Supp. 1502, 1506–07 (E.D. Va. 1994) (finding that an individual's status as an attorney did not bar him from bringing a *qui tam* action against his former employer, because the FCA did not specifically exclude lawyers from acting as *qui tam* plaintiffs); *see also* Erickson v. Am. Inst. of Biological Sciences, 716 F. Supp. 908, 912 (E.D. Va. 1989) ("In defining the classes of persons eligible to bring *qui tam* actions, Congress had a choice: It could have chosen to make eligible as *qui tam* relators only certain defined groups and persons and exclude all others or it could have chosen to include all persons as eligible *qui tam* relators with certain specific exceptions. It chose the latter scheme.").

211. The evidentiary privilege applies to disclosures of certain types of confidences communicated between client and attorney during the course of the attorney's representation of the client. The traditional justification of the privilege is enunciated in *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981):

> Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client.

Because the attorney-client privilege "impedes [the] full and free discovery of the truth," *Weil v. Investment/Indicators, Research & Management, Inc.*, 647 F.2d 18, 24 (9th Cir. 1981), and operates "in derogation of the public's 'right to every man's evidence,'" *In re Horowitz*, 482 F.2d 72, 81 (2d Cir. 1973), *cert. denied*, 414 U.S. 867 (1973), federal courts have narrowly construed its application. Thus, the privilege is determined on a case-by-case basis (see *Upjohn*, 449 U.S. at 396–97) and applies only if:

> (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate, and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358–59 (D. Mass. 1950), *overruled on other grounds by* Am. Standard, Inc. v. Pfizer, Inc., 828 F.2d 734 (Fed. Cir. 1987).

ception, as well as the general confidentiality obligation under the Model Rules, which contain a number of limited exceptions),[212] she would be able to proceed under the FCA even if that meant revealing client confidences.[213]

Increasingly, private law obligations of confidentiality are giving way to trends in public law emphasizing disclosure and transparency. This trend is most clearly articulated in federal securities law, which imposes affirmative duties on lawyers that conflict with and ultimately supersede state law obligations of confidentiality.

Section 307 of the Sarbanes-Oxley Act amounts to a pseudo-whistleblower statute for attorneys.[214] In passing the landmark securities legislation in 2002, Congress directed the SEC to prescribe "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in *any way* in the representation of issuers."[215] The SEC acted quickly. In early 2003, the Commission adopted a final rule to implement section 307.[216] The new rule requires attorneys "in the representation of an issuer"[217] to report evidence of a "material violation"[218] of securities law or breach of fiduciary duty or similar violation "up-the-ladder" within the issuer corporation to the chief legal counsel

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The only way for an attorney to overcome an assertion of the privilege by a client is to make a prima facie showing that the communication or communications in question either: (1) were made for an unlawful purpose or to further an illegal scheme or (2) reflect an ongoing or future unlawful or illegal scheme or activity. For the classic statement of this exception, see *Clark v. United States*, where "[a] client who consults an attorney for advice that will serve him in the commissions of a fraud will have no help from the law. He must let the truth be told." 289 U.S. 1, 15 (1933).

212. *See infra* notes 228–30 and accompanying text.

213. *See Doe*, 862 F. Supp. at 1506–07 (ruling that former in-house lawyer was permitted to disclose to the government his former client's confidential documents and information—under both the evidentiary privilege and the general obligation to protect client confidences—if a reasonable attorney in the circumstances would have concluded that the disputed documents and information established the employer-client's fraud). To the extent the attorney was barred from bringing the action in the instant case, it was because he did not "possess enough information that he may legally disclose to form the basis of a valid complaint" under the FCA. *Id.* at 1510. In other words, he could not satisfy the exceptions. It should be noted that while the evidentiary attorney-client privilege and the lawyer's ethical obligation to preserve client confidences are conceptually distinct as a technical matter, in practice "(1) clients do not understand the difference between the two concepts; (2) courts routinely confuse the concepts; and (3) lawyers either share in the confusion or fail to address the differences adequately." Kristi Belt & Geoffrey P. Kirshbaum, *Report of the Working Group on Confidentiality and the Limits on the Attorney-Client Privilege*, 41 S. Tex. L. Rev. 37, 37 (1999).

214. Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (codified at 15 U.S.C. § 7245 (Supp. 2003)).

215. *Id.* (emphasis added) (requiring the SEC to issue rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.").

216. 17 C.F.R. § 205.3 (2007).

217. The SEC rule covers any representation of issuers, and captures attorneys providing legal services to an issuer company who are on notice that their work might be incorporated into SEC filings. *See id.* § 205.2(g) (*In the representation of an issuer* means providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer." (emphasis added)).

218. *See infra* notes 241–42 and accompanying text.

or CEO.[219] Communicating such evidence to the company's officers or directors, the SEC has ruled, "does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation."[220] If, after "reporting up," the lawyer determines that the chief legal officer or CEO does not provide an appropriate response[221] to the evidence within a reasonable time, the lawyer is further required to report the evidence to the company's audit committee, a separate committee of independent directors, or the full board of directors. In addition, the new rule permits an attorney, *without the consent of her client*, to reveal confidential information related to her representation to the extent the attorney reasonably believes such disclosure necessary (1) to prevent the issuer from committing a material violation likely to cause substantial injury to the financial interest or property of the issuer or investors; (2) to prevent the issuer from committing or suborning perjury or perpetrating a fraud against the SEC during an investigative or administrative proceeding; or (3) to rectify the consequences of a material violation by the issuer that produced, or may later produce, substantial injury to the financial interest or property of the issuer or investors.[222] To the extent the new standards of professional conduct promulgated by the SEC conflict with state law, federal law governs, except in cases where state law imposes more stringent disclosure obligations on attorneys that are not inconsistent with the SEC rules, in which case state law governs.[223]

219. *See* 17 C.F.R. § 205.3(b) (2007). The rule does not necessarily require a nexus between the legal representation and the affirmative duty for the lawyer to be aware of a potential material violation. *But see* American Bar Association, Report of the American Bar Association Task Force on Corporate Responsibility 45 (2003) (criticizing this policy, stating that "it would be unfair to hold responsible a lawyer working in one field of the law to understand that facts of which he was aware should have led to a conclusion of law violation in a field with which he was unfamiliar.").

220. *See* 17 C.F.R. § 205.3(b) (2007).

221. An "appropriate response" would convince the lawyer, under a reasonableness standard, that no material violation occurred, is ongoing, or is about to occur, *id.* § 205.2(b)(1); that the issuer has taken appropriate action to remedy or address any past, present, or future material violation, *id.* § 205.2(b)(2); or that the issuer has retained an attorney to conduct an independent review of the alleged material violation, and that either the issuer has implemented effective remedial action or the independent review has concluded that the issuer has a colorable defense to the allegations, *id.* § 205.2(b)(3).

222. *Id.* § 205.3(d)(2) (emphasis added). The SEC's original proposal included additional provisions to section 205.3(d) that would have permitted or required attorneys under different circumstances to withdraw from representation of an issuer, to notify the SEC of the withdrawal, and to disaffirm any documents filed or submitted to the SEC on behalf of the issuer. These "noisy withdrawal" provisions were not included in the final rule, but the SEC continued to consider them "potentially important minimum standards for attorneys appearing and practicing before the Commission in the representation of issuers." Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670-01 (Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205). In a separate release issued simultaneous to the final rule, the SEC solicited additional comments on the noisy withdrawal proposals, and offered an alternative approach that would have required the issuer rather than the attorney to report an attorney's withdrawal from representation. To date, the proposal remains under consideration. *See* Implementation of Standards of Professional Conduct for Attorneys, 72 Fed. Reg. 23,640-01 (Apr. 30, 2007).

223. *See* 17 C.F.R. § 205.1 (2007).

> These standards supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflicts with this part, this part shall govern.

Id.; *see also* Giovanni P. Prezioso, SEC, Remarks Before the American Bar Association Section of Business Law 2004 Spring Meeting (Apr. 3, 2004) (stating "the Commission takes the position that its rules preempt any conflicting provision of state law").

In summary, the new rule requires attorneys representing issuer clients in any capacity to "report up" evidence of corporate malfeasance. Moreover, it permits lawyers to "report out" such evidence in the event the corporate entity does not stop, prevent, or rectify the alleged wrongdoing. Not surprisingly, the new "up-the-ladder" requirements have generated considerable debate among scholars and practitioners as to whether and to what extent the new federally imposed ethical guidelines preempt state law obligations on attorneys.[224] Congress clearly intended to supersede state laws that otherwise prevent reporting up purported violations.[225] But it is less clear whether Congress wanted to preempt state rules with respect to reporting out violations.[226] The permissive "reporting out" rule is more ambiguous of legislative and regulatory intent than the obligatory reporting up rule. There are no federal obligations, however, preventing disclosure by reporting out purported violations. And there is a good argument that the reporting out feature of the law reflects the legislative intent of the reporting up rule; namely, to expose information that if kept secret would damage markets and hurt investors. To date, the issue remains unsettled.

The sharing of client information, either through reporting up or reporting out, is not a novel concept. Even the ABA Model Rules, traditionally protective of client confidences,[227] recognize several exceptions to the general rule that a lawyer cannot share client information.[228] In fact, in 2003, the ABA responded

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224. *See, e.g.*, Susan J. Stabile, *Sarbanes-Oxley's Rules of Professional Responsibility Viewed through a Sextonian Lens*, 60 N.Y.U. Ann. Surv. Am. L. 31 (2004); Timothy P. Glynn, *One Privilege to Rule Them All?: Some Post-Sarbanes-Oxley and Other Reflections on a Federally Codified Attorney-Client Privilege*, 38 Loy. L.A. L. Rev. 597 (2004); Stephen M. Bainbridge & Christina J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, Mich. St. L. Rev. 299 (2004); Matthew Eslick, Note, *Tension Among Section 307 of the Sarbanes-Oxley Act of 2002, 17 C.F.R. § 205.3(d)(2), and State Rules Governing Disclosure of Confidential Client Information*, 53 Drake L. Rev. 133 (2004); Erin Hoch, Note, *The SEC's 307 Disclosure Rules for Sarbanes-Oxley Act: A Step in the Right Direction, But Was it a Step Too Far?*, 29 J. Corp. L. 685 (2004); Jennifer Wheeler, *Securities Law: Section 307 of the Sarbanes-Oxley Act: Irreconcilable Conflict with the ABA's Model Rule and Oklahoma Rules of Professional Conduct?*, 56 Okla. L. Rev. 461 (2003); Stephanie R.E. Patterson, Note, *Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 N.C. Banking Inst. 155 (2003). Practicing lawyers continue to feel threatened by the federal ethical guidelines issued by the SEC. "Our professional status is being challenged, if not undermined," the Association of Corporate Counsel has written, by turning lawyers into "gatekeepers" and "sentries of the marketplace." Association of Corporate Counsel, The SEC Rules for Lawyers, Three Years Later: How the SEC Now Views a Lawyer's Ethical Responsibilities 1–2 (2005), *available at* http://www.acc.com/chapters/sanant/ethicalresponsibilties.pdf.

225. *See* 15 U.S.C. § 7245 (2000) (quoting section 307 instructing the SEC to promulgate a reporting up requirement).

226. *Id.* (noting that section 307 of Sarbanes-Oxley did not provide any direction to the SEC for promulgating a reporting out requirement).

227. *See* Model Rules of Prof'l Conduct R. 1.6 cmt. 2 (2003).

> A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation . . . . This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively, and, if necessary, to advise the client to refrain from wrongful conduct.

Id.

228. *See id.* R. 1.6(b)(1) (preventing reasonably certain death or substantial bodily harm); *id.* R. 1.6(b)(2) (preventing the client from committing a crime or fraud); *id.* R. 1.6(b)(3) (rectifying or mitigating losses suffered at the hands of a client's criminal activity or fraud); *id.* R. 1.6(b)(5) (establishing a claim or defense in a case pitting the lawyer against the client); *id.* R. 1.6(b)(6) (complying with other law or a court order); *id.* R. 1.13 (protecting

directly to the SEC's reporting up and reporting out rules by acknowledging that its then-current Model Rules respecting treatment of the lawyer's obligation of confidentiality was "significantly out of step" and "increasingly dissonant" with trends in public opinion and legislative action demanding "that lawyers play a greater role in promoting corporate responsibility."[229] Subsequently, the ABA approved resolutions amending Rules 1.6 and 1.13, loosening, respectively, general confidentiality requirements and conditions for reporting out information concerning a business or organizational client.[230]

Although the Model Rules recognize conditions under which an attorney can share client confidences, those conditions are narrowly drawn, and require the presence of fraud, other criminal activity, or false testimony in an adjudicative proceeding. The bar, if you will, is high. Moreover, recent changes to the Model Rules respecting organizational clients, largely designed to encourage lawyers to improve and monitor corporate responsibility, fall short of the requirements promulgated by the SEC, which reflect the general proposition that "concerns about impacting the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation that will materially damage investors, seek to perpetrate a fraud upon the Commission in enforcement proceedings, or has used the attorney's services to commit a material violation."[231] The ABA has been very clear that changes to Rule 1.13 contain "strict conditions that must exist before any 'reporting out' is allowed."[232] In particular, the lawyer must possess "a heightened level of certainty as to the violation of law . . . the actual or threatened violation must be 'clear,'" and "there is no permission to 'report out' when the organizational governance failure involves

an organizational client from substantial injury associated with a violation of a legal obligation or a violation that might be imputed to the organization); *id.* R. 3.3(b) and cmt. [10] and [11] (stating that where the lawyer knows that a client has testified falsely, she may be required, not merely permitted, to disclose the falsity to the tribunal); *id.* R. 4.1(b) and cmt. [3] (stating that where a lawyer's withdrawal from representation will not avoid continued assistance to a client's crime or fraud, the lawyer may be required to "give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like.").

229. American Bar Association, Resolution to Amend Rule 1.6 of the Model Rules of Professional Conduct and Its Comment 15 (2003). In its report on the resolution, the ABA Task Force on Corporate Responsibility stated it believed:

> [T]he interest of society, and the bar, in assuring that a lawyer's services are not used by a client in the furtherance of a crime or a fraud creates a demanding need for an exception to the important principle of confidentiality, as most states have recognized. The importance of protecting both society and the bar from the consequences of a client's misuse of the lawyer's services in the furtherance of a serious crime or fraud must be balanced against the importance to the client-lawyer relationship of the principle of confidentiality.

Id. at 16; *see also* American Bar Association, *supra* note 219, at 35 ("In their role of promoting their organizational clients' compliance with law, a key function of lawyers is to bring issues of legal compliance to the attention of appropriate authorities within the organization."). For a discussion of lawyers balancing the duties to uphold federal securities law and preserve client confidences, see Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance Between the Obligation of Client Loyalty and Market Gatekeeper*, 16 Geo. J. Legal Ethics 91 (2002).

230. *See* American Bar Association, *supra* note 229; American Bar Association, Resolution to Amend Rule 1.13 of the Model Rules of Professional Conduct and Its Comment (2003).

231. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25.919, 68 Fed. Reg. 6320 (Jan. 29, 2003).

232. American Bar Association, Resolution to Amend Rule 1.13, *supra* note 230.

a violation of legal duty to the organization but is not otherwise a violation of law."[233] By comparison, the SEC rule allows an attorney to report out on the basis of credible evidence and a reasonable belief that a violation has occurred,[234] and it further permits an attorney to report out violations of legal obligations specific to the organization, such as violations of fiduciary duty.[235] Furthermore, while the SEC rule obliges a lawyer as a matter of law to report up evidence of covered wrongdoing,[236] Model Rule 1.13 merely directs the lawyer to "proceed as is reasonably necessary in the best interest of the organization."[237]

In addition to being considerably more permissive than the ABA Model Rules with respect to sharing client confidences, federal securities law preempts state standards of professional conduct.[238] Recall that the SEC rule *requires* attorneys to report up evidence of a "material violation" of securities law or breach of fiduciary duty or similar violation,[239] and *permits* them to report out such evidence in the event the organization does not take appropriate steps to remedy the violation.[240] The SEC defines "material violation" for purposes of its reporting up and reporting out rule in somewhat circular fashion as "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law."[241] The SEC adopts the generally accepted definition of "materiality" under federal securities laws, which emphasizes the significance of an omitted fact to a reasonable investor, and whether that information would be relevant to her in making a decision to buy, hold, or sell a security.[242] Under this definition, all infractions of the law are not material. But material infractions must not necessarily rise to the level of fraud or criminal activity before the SEC rule requires them to be reported up or allows them to be reported out. Meanwhile, the ABA rule does not even

233. *Id.*

234. The SEC defines "evidence of a material violation" as "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." 17 C.F.R. § 205.2(e) (2007).

235. *See id.* §§ 205.2(i), 205.3(b).

236. *See id.* § 205.3(b); *see also supra* notes 217–21 and accompanying text.

237. *See* Model Rules of Prof'l Conduct R. 1.13 (2003).

238. *See* 17 C.F.R. § 205.1; *supra* note 223 and accompanying text.

239. *See supra* notes 217–21 and accompanying text.

240. *See supra* note 222 and accompanying text.

241. 17 C.F.R. § 205.2(i).

242. The SEC final rule cites *Basic, Inc. v. Levinson*, 485 U.S. 224, 231–36 (1988) and *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976), both of which define materiality as follows:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

allow the attorney to report up violations if she does not believe disclosure to be "in the best interest of the organization."[243]

The standards of professional conduct covering lawyers under federal securities law not only impose higher obligations on attorneys than state ethical rules with respect to sharing client confidences. They also directly implicate legal representation associated with providing tax advice, a professional endeavor intimately "intertwined with a company's finances, financial statements, and governance procedures."[244] Indeed, given the broad purview of the SEC rule—covering *any* representation of issuers involving preparation of documents the attorney knows or should know will be filed with or incorporated into an SEC filing—providing tax advice to an issuer places the tax lawyer squarely within the scope of the reporting up and reporting out obligations. In this respect, Sarbanes-Oxley requires tax lawyers to share client information associated with material violations of state and federal law, including internal revenue laws.

Although Sarbanes-Oxley requires tax lawyers to share confidential information in certain circumstances, and under relatively low standards of proof,[245] the inherent ambiguity in tax law might prevent lawyers from sharing such information even if they wanted to blow the whistle on clients. Credible evidence of tax fraud is an easy case, clearly covered by statute. But what about credible evidence of a particularly aggressive tax position or transaction on which the Treasury has not opined, the case law is silent or ambiguous, and the position or transaction is not a sham per se, reflecting at least a modicum of economic substance?[246] Such a violation is considerably less clear in this case, as is the authority under Sarbanes-Oxley to report up or to report out client information. Both the current Service bounty approach and the recommended *qui tam* approach provide economic incentives to sell out confidential client information. Exceptions to confidentiality obligations of lawyers should not be triggered by the prospect of personal gain. In fact, the Model Rules explicitly prohibit such activity.[247] Therefore, we might be inclined to exclude lawyers from both the whistleblower statute and any prospective *qui tam* for tax statute. However, we must also balance the lawyer's confidentiality obligations against

243. Model Rules of Prof'l Conduct R. 1.13(b) (2003).

244. George R. Goodman, *The Taxpayer's and Tax Adviser's Guide to Sarbanes-Oxley*, 100 Tax Notes (TA) 691, 698 (Aug. 4, 2003).

245. *See* 17 C.F.R. § 205.2(e) (2007).

246. The economic substance doctrine has been a particularly effective tool in the fight against tax shelters, and reflects an amalgam of other common law anti-abuse doctrines, including business purpose, sham transaction, and substance over form. At its heart, the economic substance doctrine represents a judicial effort "to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." Coltec Industries, Inc. v. United States, 454 F.3d 1340, 1353–54 (Fed. Cir. 2006). *See, e.g.*, Dennis J. Ventry, Jr., *Save the Economic Substance Doctrine from Congress*, 118 Tax Notes (TA) 1405 (Mar. 31, 2008); David P. Hariton, *When and How Should the Economic Substance Doctrine Be Applied?*, 60 Tax L. Rev. 29 (2006); Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. Rev. 47 (2001); Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5 (2000).

247. *See* Model Code Of Prof'l Conduct R. 1.8(b) (2003) (prohibiting both use of information for lawyer's personal gain and use of information to client's disadvantage).

the benefits of including lawyers in these statutes. As discussed *supra*,[248] both in-house and outside counsel are in unique positions to detect and deter non-compliant behavior. Shifting enforcement obligations to these private parties with lower costs of monitoring can be an efficient and potentially optimal compliance approach.

Recent legislative and administrative changes to federal law pertaining to corporate governance indicate a strong preference for raising rather than lowering lawyers' obligations to report violations of the law, even if that means disclosing confidential client information. Congress enacted Sarbanes-Oxley in part because "some lawyers [had] forgotten their responsibility" to the corporate entity, to the market, and to investors.[249] In addition, according to the SEC as well as members of Congress and expert observers, state ethical rules had failed utterly as "an effective deterrent to attorney misconduct,"[250] notwithstanding the organized bar's empty and repeated injunctions to the contrary.[251] Recent amendments to Circular 230 regulations governing standards of tax practice[252] represent yet another example of federal regulators and legislators attempting to improve compliance with the law by deputizing lawyers and turning them into compliance counselors rather than overzealous client advocates.[253] Both Sarbanes-Oxley and Circular 230 amendments reflect a discernible regulatory trend toward "creeping external regulation of lawyers by administrative

248. *See supra* notes 85–89, 139–41 and accompanying text.

249. 148 Cong. Rec. S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards); *see also* Harvey L. Pitt, SEC Chairman, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002), *available at* http://www.sec.gov/news/speech/spch579.htm (stating "recent events have refocused our attention on the need for the profession to assist us in ensuring that fundamental tenets of professionalism, ethics, and integrity work to ensure investor confidence in public companies.").

250. *Supra* note 231 and accompanying text; *see also* 148 Cong. Rec. S6555 (daily ed. July 10, 2002) (statement of Sen. Enzi) ("I am usually in the camp that believes that States should regulate professionals within their jurisdiction. However, in this case, the State bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced."); *see generally* Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 Colum. L. Rev. 1236, 278–80 (2003); Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 Harv. J.L. & Pub. Pol'y 195, 216, 225–26 (2003).

251. *See* American Bar Association, Independence of the Legal Profession: Section 307 of the Sarbanes-Oxley Act (Dec. 1, 2004), *available at* http://www.abanet.org/poladv/priorities/sarbanes.html ("State court ethical rules are enforceable through a range of sanctions, including suspension and disbarment. These state court rules have worked well over time, and additional rules are unnecessary.").

252. Circular 230, *supra* note 185. Amendments to the regulations in June 2005 raised reporting and disclosure standards for tax practitioners, particularly with respect to written advice. *See, e.g.*, Deborah H. Schenk, *The Circular 230 Amendments: Time to Throw Them Out and Start Over*, 110 Tax Notes (TA) 1311 (Mar. 20, 2006); David T. Moldenhauer, *Circular 230 Opinion Standards, Legal Ethics and First Amendment Limitations on the Regulation of Professional Speech by Lawyers*, 29 Seattle U. L. Rev. 843, 844–46 (2006); Michael Schler, *Effects of Anti-Tax-Shelter Rules on Nonshelter Tax Practice*, 109 Tax Notes (TA) 915, 918–22 (Nov. 14, 2005); Jeffrey H. Paravano & Melinda L. Reynolds, *The New Circular 230 Regulations—Best Practices or Scarlet Letter?*, 46 Tax Mgmt. Memo. (BNA) 339 (2005).

253. *See, e.g.*, Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 Conn. L. Rev. ___ (2008) (describing amendments to Circular 230 as government efforts to raise "the ethical bar on tax practitioners, deputizing them (largely involuntarily) in the fight against abusive tax shelters"); William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 Fordham L. Rev. 1453, 1471 (2006) (noting that Circular 230 changes involved "auditing lawyers and accountants, as a means of assessing the reliability of their vouching for their clients"); *see also* Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 Conn. L. Rev. 1185, 1194–97, 1207–15 (2003).

agencies."[254] Such efforts recognize that insiders, particularly lawyer-insiders, are well positioned to identify, address, and remedy violations of state and federal law.[255] Moreover, Sarbanes-Oxley extends protections to these lawyer-whistleblowers, including those who expose material violations of tax law.[256] There is no reason to believe that Sarbanes-Oxley whistleblower provisions do not protect attorneys covered by section 307 who, after exhausting their reporting up obligations, decide to report out purported violations.[257]

There may be a difference worth noting between Sarbanes-Oxley disclosure requirements and those in the tax context.[258] Sarbanes-Oxley and other corporate governance efforts are concerned with duties owed either to the client itself (*i.e.*, the corporation rather than individual officers and directors) or to persons to whom the client owes a fiduciary duty (*i.e.*, shareholders). Thus, in the Sarbanes-Oxley context, disclosure may not only be in the client's best interests, but actually required by them. In the tax context, by comparison, disclosure of aggressive tax transactions can hurt the client in that it results in the client paying out more in taxes. In this way, tax disclosures are not the same as corporate governance disclosures that expose errant managers or concealment of information that should be available to the market. However, disclosure in the tax context is analogous to disclosure in the corporate governance context for at least three reasons. First, disclosing purported tax violations could fulfill rather than violate a lawyer's fiduciary duty to the client to the extent the violations were potentially damaging in the long-run; that is, if the cost of the violations (expenses associated with Service examination, potential litigation, penalties and interest owed on back taxes) exceeded the expected benefits (tax savings). Second, if the purported violations rose to the level of tax cheating that could potentially hurt the client or conceal information from the market, disclosure once again would fulfill rather than violate a lawyer's fiduciary duty in addition to her duty of loyalty. Finally, even if the purported violations fell short of tax cheating, disclosure could save the client from subsequent negative publicity that could adversely effect stock price or firm image among investors and customers in the event the tax reporting position was challenged, litigated, and invalidated.

254. Anthony C. Infanti, *Eyes Wide Shut: Surveying Erosion of Professionalism of the Tax Bar*, 101 Tax Notes (TA) 517, 528 n.121 (2003).

255. *See, e.g.*, Sheryl Stratton, *ABA Tax Section Meeting: Everson to Tax Bar: You Should Do More*, 114 Tax Notes (TA) 404, 404 (Jan. 9, 2007) (quoting Commissioner of Internal Revenue Everson as expecting tax professionals "to do more to protect the integrity of the system"); Tom Gilroy, *Tax Fraud: IRS Chief Counsel Calls Practitioners 'First Line of Defense' Against Fraud*, Daily Tax Rep. (BNA), Oct. 25, 2006, at G-3 (quoting Service Chief Counsel Donald Korb as calling tax practitioners "the first line of defense" against overaggressive tax avoidance behavior); 17 C.F.R. § 205.3 (2007) (serving "to deter corporate misconduct and fraud" and "improve the corporate governance").

256. *See supra* notes 158–163 and accompanying text.

257. In the context of environmental regulation, the Fifth Circuit recently held that an attorney may invoke whistleblower protection under federal law. *See* Willy v. Admin. Review Bd., 423 F.3d 483, 496–501 (5th Cir. 2005) (holding that under federal environmental whistleblower protection laws an attorney may use otherwise privileged information against an employer for wrongful discharge).

258. I am grateful to William Simon for this insight.

The duty of confidentiality continues to give way to broader public policies emphasizing disclosure and transparency. Recently, the Department of Justice briefed the limitations on the obligation of confidentiality owed by an employee to an employer arising by operation of an express confidentiality agreement or common law fiduciary duty. "For public policy reasons," the DOJ wrote in the context of the FCA, "agreements that purport to limit the right of a party to cooperate with a criminal investigation or to disclose matters of public importance are unenforceable."[259] Violations of an employment contract or fiduciary duty are covered by state law; therefore, it should follow that confidentiality requirements imposed on attorneys by state law "that purport to limit the right of a party to cooperate with a criminal investigation or to disclose matters of public importance" are similarly unenforceable as against public policy.[260] Congress, meanwhile, has continued to add protections and avenues for prosecuting whistleblower claims with new legislation for informants acting under federal whistleblower statutes.[261]

Sarbanes-Oxley, Circular 230, and the new tax informant statute all reflect the underlying public policy of whistleblower statutes "to enhance the Government's ability to recover losses sustained as a result of fraud against the Government."[262] Moreover, Sarbanes-Oxley and the tax whistleblower law permit even lower thresholds than fraud before employee-insiders are allowed and, in some cases, required to expose alleged wrongdoing, even if such disclosure means sharing client confidences. Indeed, where public law meets private law, as in the realm of securities and tax law, public law and public policy increasingly prevail.

VIII. CONCLUSION

The 2006 amendments to the Service whistleblower statute created a powerful system of private enforcement of public tax laws. The centralized Whistleblower Office and substantially increased awards for informants have the potential to improve greatly the monitoring and enforcement of government tax compliance efforts. Allowing private citizens to prosecute alleged tax abuses in the form of *qui tam* litigation would inject an additional element of risk into a taxpayer's evaluation of how to comply with the tax law, and could greatly alter tax compliance norms

259. Brief for Relators as Amicus Curiae Supporting Motion to Dismiss Counterclaims, United States v. Cancer Treatment Ctrs. of Am., 350 F. Supp. 2d 765 (E.D. Ill. 2004) (No. 99C 8287); *see also* Town of Newton v. Rumery, 480 U.S. 386, 392 (1987) ("[A] promise is unenforceable if the interest in its enforcement is outweighed in the circumstances by a public policy harmed by enforcement of the agreement"); X Corp. v. Doe, 805 F. Supp. 1298, 1310 n.24 (E.D. Va. 1992) (noting in a case involving the FCA brought by defendant's attorney that confidentiality agreements restricting individuals from disclosing evidence of fraud to the government are void as against public policy).

260. Brief for Relators, *supra* note 259.

261. *See* Federal Employee Protection of Disclosures Act, S. 274, 110th Cong. (2007); Whistleblower Protection Enhancement Act of 2007, H.R. 985, 110th Cong. (as passed by House of Representatives, March 14, 2007); Floor Statement of Senator Chuck Grassley, *supra* note 4 and accompanying text; Alison Bennett, *Tax Administrator Grassley Kicks Off Whistleblower Week, Urges Support for Whistleblower Protections*, Daily Tax Rep. (BNA), May 15, 2007, at G-3.

262. S. Rep. No. 99-345, at 1 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5266, 5266.

within organizations, deterring overaggressive tax planning at the source. Private enforcement and prosecution of public law can be an especially effective compliance mechanism in the area of tax regulation where tax officials face unusually steep information deficits, active concealment by taxpayers, and insufficient resources to enforce the tax laws. Though critics of the enhanced tax whistleblower statute have suggested that it threatens to undermine confidentiality obligations by encouraging tax professionals and employees to expose tax-deviant clients and employers, the new law reflects a trend in federal securities and tax regulation emphasizing disclosure and transparency even when such disclosure conflicts with traditional obligations of confidentiality.