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Age Of The Whistleblower: Incentives And Protections

Law360, New York (September 06, 2012, 12:40 PM ET) -- Nobody likes a snitch. At least that is what we all learn from day one in the schoolyard. Next to engaging in the dirty deed yourself, squealing is about the worst thing you can do. Better to stay quiet, look the other way, mind your own business, than to stick your nose into someone else's affairs. And lessons are soon learned for those who do not abide. Name-calling. Isolation. And worst of all — retaliation.

But that was then. Perhaps it was the 9/11 wakeup call that we live in a more dangerous world. Maybe we no longer trust the government to look out for us the way we think it should. Or maybe it is simply about corporate plunder and the ever-widening gulf between the haves and have-nots. Whatever it is, a new mindset pervades — where getting involved is the right thing to do after all; where if you see something you are supposed to say something. And with this new outlook has come some additional prodding from a host of newly energized regulations that sweeten the pot considerably for these newfound heroes.

Blair Hamrick

Take Blair Hamrick for example. He probably never thought that one day he would be credited with saving the country billions of dollars. Nor did he think he would protect the health and safety of thousands of people he does not even know. But that is exactly what happened after he tipped off the federal government that his former employer, pharmaceutical giant GlaxoSmithKline, was playing fast and loose with the drugs it was selling to the American public.

His story began in 1993, when he moved across the country to Colorado to take on a cushy six-figure position as a pharmaceuticals representative for Glaxo. It was not long before Hamrick discovered that his new employer was engaged in widespread fraud, marketing drugs for purposes that they were not approved for and providing kickbacks to doctors to promote the illegal scheme. At first, Hamrick persuaded himself that these strategies were acceptable because even if the tactics were questionable, patients were receiving their medicine.

Over time, though, he realized that what Glaxo was having him do could be causing more harm than good. For example, Glaxo was marketing Paxil, a powerful anti-depressant, for use by children despite the fact that the drug was not tested or approved for their use. Likewise, Glaxo was marketing Wellbutrin, another anti-depressant, for all kinds of unapproved uses, ranging from treatment of sexual dysfunction to weight loss. The company marketed the drug as the "happy, horny, skinny pill." In 2001, Hamrick and a fellow whistleblower reported their concerns to managers. Glaxo's internal investigation verified their allegations but the company took no action.

Unable to stand by and allow these abuses to continue, Hamrick alerted federal authorities and filed a qui tam complaint under the False Claims Act. That is a type of lawsuit a whistleblower can bring on behalf of the government for fraud committed against the government. Thanks in no small part to Hamrick's courage and perseverance to blow the whistle on Glaxo, this summer the government reached the largest health care settlement in history — $3 billion — to settle several criminal and civil charges against Glaxo.

Hamrick's story is unique, but he is certainly not alone in blowing the whistle on corporate fraud. There are scores of laws, both state and federal (and sometimes even city), that protect this activity. Many of these laws also offer hefty rewards to encourage people to come forward and endure what can often be a very difficult and unpleasant ordeal. For example, in 2010, Glaxo settled for $750 million a different set of charges, that time relating to its sale of ineffective and contaminated drugs. The whistleblower there received almost $100 million for her trouble. Hamrick and his fellow whistleblowers in Glaxo's most recent fiasco are likely to receive a similar prize.

The False Claims Act

From consumer products, to securities trading, to health care, to the military, to transportation, to nuclear energy — you name the industry — if it is one that implicates the American public, it is likely to have its own whistleblower statute. The most significant of these laws is the FCA under which Hamrick filed his qui tam action. Also known as the Lincoln Law, it was enacted in 1863 to combat widespread fraud by companies selling rancid food, ailing mules, and defective weapons to the Union Army during the Civil War.

Recognizing that the government could not sniff out all of the fraud on its own, the law reached back to 13th-century England to revive the tradition of the qui tam, derived from the Latin phrase "he who pursues this action on our Lord the King's behalf as well as his own." Not only does it permit private citizens, known as relators, to step up to the plate on the government's behalf. It rewards them heavily for doing so by awarding them a sizeable chunk of any government recovery.

Despite its lofty aspiration and early promise, the FCA was largely ignored for most of the next century. It was relegated even further to the sidelines when in the 1940s Congress sharply restricted the amount a qui tam relator could recover under the statute. The government did not seem all that interested in enlisting the support of its citizens to help police the public fisc. That began to change, however, in the 1980s during the increase in military spending during the Reagan presidency.

And in 1986, amid widespread reports of outrageous abuses by government contractors — the infamous $400 hammers, $1,000 bolts and $7,000 coffee pots — Iowa's Republican Sen. Charles Grassley succeeded in putting some serious teeth back into the FCA. The law was amended to impose triple damages on wrongdoers, reward whistleblowers with up to 30 percent of the government's recovery, and include significant anti-retaliation protections for employees who blow the whistle.

It took a few years for the public to catch on, but by the mid-1990s, hundreds of millions of dollars were being returned to the government through the FCA every year, with tens of millions going to whistleblowers. By 2000, these annual recoveries extended into the billions as the law's reach expanded beyond unscrupulous defense contractors to pursue fraud in other industries, such as health care and banking.

In 2011 alone, the government reclaimed more than $3 billion, with roughly $530 million of that going to the whistleblowers that spawned these actions. That figure has already been far surpassed this year with the $3 billion Glaxo settlement, the $1.5 billion

settlement with Abbott Labs (over Depakote), and the billions more the government is poised to secure from Johnson & Johnson (over Risperdal) and Bank of America and others over the ongoing mortgage scandal.

Expanded Protections and Rewards

There is no question that the FCA has been the most important tool in combating fraud and protecting and rewarding whistleblowers. But it has its shortcomings, the biggest one being that it only applies when the government is the subject of the fraud. Fraud on investors in securities, for example, is not covered unless the government is the actual investor (such as through an employee pension fund). Without the incentives offered under the FCA, fraud in these cases may go unreported until it is too late.

The Enron debacle provides a striking example. We all know what happened. Enron cooked its books for years. Shareholders lost billions. Thousands of employees lost their jobs. The ripple effects went far beyond those immediately connected to the company. The scheme was complex, involving not only top executives, but the company's outside accounting firm Arthur Anderson. We'll never know just how many people knew or at least suspected that something was amiss. But something so big and byzantine could not have gone unnoticed for as long as it did. Yet, while Enron's elite were building their phantom empire, no one came forward to alert the authorities. If they did, they certainly did not try hard enough.

This lapse was not necessarily because no one cared. Just before Enron's collapse, Sherron Watkins, an Enron vice president for corporate development, wrote an anonymous letter to her CEO, Kenneth Lay, expressing her fear that Enron "will implode in a wave of accounting scandal." Within months, that is precisely what happened as the company, its employees, and its investors went down in flames.

This catastrophe might have been avoided if Watkins or some other whistleblower had come forward earlier. Many insiders may have felt compelled to do something. But why would they when there were no protections or rewards in place to counter the likelihood of retaliation and estrangement. With jobs to keep and families to feed, it is not all that surprising that no whistleblowers emerged to save the day. The Sarbanes-Oxley Act of 2002, passed in the wake of the Enron fiasco, attempted to prevent this failure from repeating itself by providing strict protections for corporate whistleblowers. A public company cannot fire or otherwise harass or discriminate against an employee for disclosing securities fraud.

Sarbanes-Oxley was a step in the right direction but it did not go far enough. For most people, merely protecting them from retaliation is unlikely to motivate them to squeal on their employer and colleagues. The chance for riches, however, may do the trick. That is where the recently enacted Dodd-Frank Act comes in. This legislation was Congress' response to the Great Recession and the wild west behavior of the Wall Street institutions that led us there.

Among its sweeping reforms are two whistleblower provisions that went into effect last year. They are mirror images of each other and derive largely from the FCA. Each provides anti-retaliation protections and awards of up to 30 percent of any government recovery relating to fraud or other misconduct in the sale of securities, or in the sale of commodities futures (such as in oil, precious metals, and certain agricultural products). Given that this kind of fraud can easily affect billions of dollars of trading activity, these provisions offer up a mighty powerful incentive for whistleblowers. And the best part — unlike the FCA, the whistleblower provisions under Dodd-Frank do not require that the fraud be on the government. Fraud on private investors or the market generally is all that is needed.

In addition, as part of this legislation, the agencies responsible for regulating the trading of

securities (U.S. Securities and Exchange Commission) and commodities (U.S. Commodity Futures Trading Commission) have established whistleblower offices dedicated exclusively to working with whistleblowers. So while it may be too early to tell exactly how these new whistleblower provisions will pan out, it is a pretty safe bet that their impact will be significant. Indeed, the SEC recently announced that there are already 60 cases this year for which whistleblowers may seek a reward.

Think about how the Madoff fiasco might have gone differently had this legislation been in place. With the lure of a multimillion-dollar bounty, Harry Markopolos would have had plenty of company in his efforts to divulge the fraud to the regulators. And with a dedicated whistleblower office, the SEC would have been hard-pressed to ignore this chorus of complaints.

Age of the Whistleblower

Over the past two decades, the role of the whistleblower has become increasingly important to the government and its efforts to protect the American public. Not only has there been new whistleblower legislation, but existing legislation has been revamped and reenergized. The FCA, for example, underwent two rounds of major changes in 2009 and 2010 that make it much easier and safer for whistleblowers to step forward. And the number of whistleblower complaints and the role they play in government enforcement continues to grow. In 2011, there were roughly 760 FCA matters opened, about 640 of which (or 85 percent) were initiated by whistleblowers. This represents quite a sea change in FCA enforcement compared to the mid-1980s when whistleblowers initiated less than 10 percent of FCA claims.

There are no signs that this surge of "private attorney general" enforcement will be letting up. The IRS just publicly proclaimed that it will more aggressively pursue the flood of whistleblower reports of tax fraud the agency is receiving under its recently enacted version of the FCA. And additional legislation is around the corner with more and more states getting into the act, and with the Whistleblower Protection Enhancement Act, which would expand to government contractors whistleblower protections currently enjoyed by federal employees. This and other proposed legislation should only further fuel the growing flame of private citizens standing up against corporate fraud.

For every Deep Throat blowing the whistle on corruption, there is a potential whistleblower who does not come forward. In fact, roughly one-third of all fraud that is witnessed today still goes unreported. We clearly still have a long way to go to shake that old schoolyard stigma against snitches. But the protections and incentives are there and growing still. The mindset is changing. And thanks to the likes of Blair Hamrick and other whistleblowers stepping forward we may soon get to that place where we will never see another Enron or Madoff; where the alarm will be sounded well in advance of the next mortgage crisis, Space Shuttle disaster, or pharmaceutical screw-up.

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