

**Lincoln's Law  
An Analysis of an Australian False Claims Act**

Dr Kim Sawyer

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**1. Introduction**

A law is more than a mechanism for arbitrating right and wrong. A law creates disincentives for wrongdoing; but it can also create incentives for doing the right thing. This is particularly the case for laws such as Good Samaritan legislation and whistleblowing legislation, which are designed to protect citizens and to create incentives for citizens to reveal wrongdoing. The US False Claims Act (FCA), otherwise known as Lincoln's Law, is one of the few laws where these incentives are prescribed by a monetary entitlement. The incentives and disincentives created by a law establish a market of compliance with the law and, just as in a financial market, the efficiency of a compliance market can be assessed. The efficiency of a law's compliance market determines the efficiency of the law. In this paper, we consider the efficiency of whistleblowing legislation with a particular application to Australia.

In a law's compliance market, prosecutions under the law become the transactions of the market. The transaction cost is the cost of prosecution, and the transaction price is the penalty determined by the prosecution of the case. It is prosecutions which determine the efficiency of the market of compliance and, by implication, the efficiency of the law. As in a financial market, the efficiency of a compliance market can be assessed in terms of the cost of transacting, the liquidity of the market and the information efficiency of the market. The transaction cost consists of the direct monetary cost of prosecution and the indirect cost in terms of the time taken to

prosecute. A crime which takes many years to be prosecuted imposes a higher transactions cost, not only because of the costs of investigation, but also because of the opportunity costs imposed on other investigations and on those violated by the crime. Like all markets, immediacy is an important component of an efficient compliance market. The liquidity of a compliance market can be measured by the number of prosecutions, or by the proportion of violations that are prosecuted. An illiquid market is one where there have been no prosecutions. For example, in Australia, there has been no prosecution under whistleblowing legislation; it is a highly illiquid compliance market. Finally, a compliance market is information efficient if the transaction prices fully reflect all public and private information, just like the information efficiency in a financial market.<sup>1</sup> In this case, the prices are the penalties imposed on violators, and information is the information in all previous prosecutions of the law, and all other relevant information. When a compliance market is information efficient, all relevant information is reflected in the penalties and those penalties become a deterrent to future violations of the law. Analogous to financial markets, a law is more efficient when the direct and indirect costs of prosecution are lower, when the proportion of prosecutions for every violation is higher, and when information is fully impounded so that the deterrence of future violations is maximised. The challenge for legislators is to create a set of disincentives and incentives which lower prosecution costs, raise the probability of prosecution, and increase the deterrence of future violations, thus making the law more efficient.

Imparting efficiency to a compliance market is not as simple as imparting efficiency to a financial market. Transactions costs in financial markets have been lowered through better market design, such as electronic trading, more transparent systems, and

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<sup>1</sup> See E. Fama Efficient Capital Markets: A Review of Theory and Empirical Work". *Journal of Finance* **25** (2): 383–417. May 1970.

increased trading hours. The design of a compliance market is more complicated. Technology alone will not make laws more efficient. To simultaneously lower prosecution costs and increase the probability of prosecution is often not feasible, even with the advances in database technology, in CCTV technology and DNA technology. The complexity of systems often renders detection of crime difficult, lowering the probability of prosecution; this is particularly the case for white collar crimes such as insider trading. Legislation is typically designed under the assumption of a maximum probability of prosecution. Emerging laws, that is, laws which have a relatively short history, amplify this approach. Legislators respond to a problem with laws which assume that the probability of detection and prosecution is maximised, but which ignore the costs of prosecution and more generally the efficiency of the legislation. Whistleblowing legislation is an example. Before the 1980s, whistleblower protection legislation did not exist in any meaningful form in any country. But the need to protect whistleblowers from well documented retaliation<sup>2</sup> led to a legislative response which has iterated towards a more comprehensive framework of legislation. But legislators remain uncertain as to the best response. Australia, for example, still does not have Federal legislation. And the efficiency of the various legislations has not been measured, principally because costs of prosecution, probabilities of prosecution and the deterrent effect of legislation are intangibles that are difficult to estimate.

The US False Claims Act (FCA) does permit some assessment of its efficiency. The FCA allows individuals to act on behalf of the US Government to prosecute those who falsely claim on the Government. The FCA was an old law which had become dormant until 1986 when legislators realised that inside information was required to combat a culture

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<sup>2</sup> See for example, Rothschild, J and T. Miethe: 1999, 'Whistle-Blower Disclosures and Management Retaliation', *Work and Occupations* 26(1), 107-128.

of non-compliance in government contracting. The FCA depends on whistleblowers with access to specific information to unravel anomalies in contracting. The efficiency of the FCA admits some measurement because the costs of prosecuting the FCA are measured, the probabilities of prosecution can be estimated in terms of successful litigations, and the deterrent effects of the Act can be estimated given a set of assumptions. Furthermore, the penalties imposed on violators and the benefits accruing to the government can also be estimated. As such, the FCA has become the most transparent of all whistleblowing laws and in terms of the market for compliance, it is more efficient than other whistleblowing legislation.

The principle of the FCA is to consider the contractual relationship between an entity and the government. Every contract, except in special circumstances, becomes subject to the FCA. The FCA emphasises

- (i) Contract design and contract compliance
- (ii) Penalising non-compliance
- (iii) Protection for those who disclose non-compliance
- (iv) Incentives for those who disclose non-compliance and
- (v) Deterrence of non-compliance.

Whistleblowing protection is then embedded within a framework where the costs and benefits of whistleblowing can be measured, and where the costs of prosecution and the deterrence of legislation can also be estimated. It is the measurability of the FCA that makes it a powerful act for whistleblowers.

These issues will be explored in the analysis below, beginning with a model of whistleblowing protection, followed by a review of the FCA, a review of Australian legislation, and concluding with some recommendations for an Australian framework.

## **2. An Efficient Model of Whistleblowing Protection**

Australia is not alone in its uncertainty about a framework for whistleblowing legislation. In the United States, there are at least 50 different laws related to whistleblowing. But the US legislation does appear to be converging on one issue; the need for incentives. Incentives change the approach to whistleblowing from an ex-post protection of a whistleblower to an ex-ante encouragement of a whistleblower. Incentives are critical to the design of optimal whistleblowing legislation. Vaughin, Devine and Henderson attempted to answer the question as to what are the principles of an ideal whistleblowing law.<sup>3</sup> They proposed the following principles

- (1) Focus on the information disclosed, not the whistleblower.
- (2) Relate the law to freedom of expression laws.
- (3) Permit disclosure to different agencies in different forms.
- (4) Include compensation or incentives for disclosure.
- (5) Protect any disclosure, whether internal or external, whether by citizen or employee.
- (6) Involve whistleblowers in the process of the evaluation of their disclosure.
- (7) Have standards of disclosure.

These principles suggest a more competitive whistleblowing model where the focus is on information rather than who discloses or receives information, where economic incentives play a role, and where the efficiency of disclosures is paramount.

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<sup>3</sup> Vaughin, R., Devine, T. and K. Henderson (2003), 'The Whistleblower Statute Prepared for the Organization of American States and the Global Legal Revolution Protecting Whistleblowers', *George Washington International Law Review* 35(4), 857-902.

Existing approaches to whistleblowing have elevated the moral but not the economic imperative of whistleblowing. Whistleblowing needs to be recognised as a powerful weapon to combat waste of government funds. The objective of whistleblowing legislation must be to change a culture of non-compliance into a culture of compliance. The objectives simply stated should be to protect whistleblowers, to deter those who violate contracts with the government, and to recover the proceeds of those violations. And, like most economic problems, whistleblowing can be subjected to a cost-benefit analysis and to an analysis of incentives and disincentives. When the benefits of whistleblowing are measured, whistleblowers are protected because governments understand their value. A cost-benefit analysis of whistleblowing should be a pre-requisite to any whistleblower protection legislation; and a pre-requisite to the assessment of any whistleblower protection legislation.

Whistleblowing, in simple terms, is a public-private partnership between the government and a whistleblower. A whistleblower who discloses in the public interest is acting on behalf of the government of the future. The partnership between the government and whistleblowers is complex and the protection of whistleblowers is only one element of that partnership. Many of the existing laws on whistleblowing have failed to consider the terms of this partnership and how they compare to other public-private partnerships. Like all public-private partnerships, the partnership between the government and the whistleblower involves risks, costs and benefits. While there have been limited cost-benefit analyses of the government's role or the whistleblower's role, it is generally acknowledged that a whistleblower assumes most of the risk and most of the cost. The government receives the benefit, often without risk. It is a very unusual risk-sharing partnership. The objective of whistleblowing legislation must be to transfer some of the risk and some of the cost away from the whistleblower; and to transfer some of the benefit towards the whistleblower. That would represent a more efficient

distribution of the risks, costs, and benefits of whistleblowing. And lead to more efficient disclosures. Necessarily, better risk-sharing will involve incentives for whistleblowers.

The whistleblower is exposed to three types of risk which are considered seriatim

- (1) Retaliation risk
- (2) Litigation risk
- (3) Reputation risk

### **Retaliation risk**

The retaliation against whistleblowers is well documented. A comprehensive survey of US whistleblowers by Rothschild and Miethe<sup>4</sup> of 761 individuals found that 69 percent of the whistleblowers lost their job or were forced to retire. This is supported by more recent evidence by Dyck, Morse and Zingales<sup>5</sup> in a study of 230 cases of corporate fraud not covered by the False Claims Act between 1996 and 2004. They found that in 82% of cases with named employees, the individual alleges that they were fired, quit under duress, or had significantly altered responsibilities as a result of bringing the fraud to light. Protection against retaliation is often not well-specified. In Australia, the 2009 *Whistleblowing Protection* report<sup>6</sup>, for example, recommended that the proposed *Public Interest Disclosure Bill* define the right to make a disclosure as a workplace right and enable any matter of adverse treatment in the workplace to be referred to the

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<sup>4</sup> Rothschild, J and T. Miethe: 1999, 'Whistle-Blower Disclosures and Management Retaliation', *Work and Occupations* 26(1), 107-128.

<sup>5</sup> Dyck, A., A. Morse, and L. Zingales. 2010. Who Blows the Whistle on Corporate Fraud? *Journal of Finance*, forthcoming.

<sup>6</sup> *Whistleblowing Protection*, House of Representatives Standing Committee on Legal and Constitutional Affairs Report on Whistleblowing Protection Within the Australian Government Public Sector 2009

Commonwealth Workplace Ombudsman for resolution as a workplace relations issue. This recommendation should be contrasted with the mandatory provisions of the US False Claims Act discussed in Section 3 below. Retaliatory provisions have to be specific and mandatory to be effective.

### **Litigation risk**

The whistleblower faces significant litigation risk from two sources. First, there is the risk associated with the information revealed. Bad news is always associated with the risk of litigation to those who disclose the news. Secondly, whistleblowers are often forced into litigation to redress retaliation. Litigation risk is high and a significant deterrent to blowing the whistle.

### **Reputation risk**

Whistleblowers also face significant reputation risk, which restricts job opportunities in the future. Rothschild and Miethe, for example, found that 64 percent were blacklisted from getting another job in their field. The most successful whistleblowers are those that change their careers.

In sum, the whistleblower trades off the benefits of blowing the whistle with the costs imposed by retaliation, litigation and reputation risk. Their net benefit is

$$Net\ Benefit = E(Benefit) - E(Retaliatio\ Cost) - E(Litigatio\ Cost) - E(Reputatio\ Cost) \quad (1)$$

where  $E(x)$  represents the expected value of  $x$ . To blow the whistle, the net benefit to the whistleblower must be positive. Without incentives, this is unlikely to be the case. As



Depoorter and De Mot<sup>7</sup> observe, incentives must be set very high to eliminate the stigma and loss of opportunities in the job market. The moral imperative is usually not sufficiently high to render the net benefit positive.

Many whistleblowing laws and proposed laws consider only the issue of reducing the expected retaliation cost, ignoring expected litigation risk, expected reputational risk and any expected benefits. Unsurprisingly, the most effective disclosures are often anonymous; but anonymous disclosures tend to be less credible and less informative. The challenge is to establish incentives which increase the net benefits for whistleblowers without increasing opportunistic behaviour. Optimising the incentives is not a simple problem. The incentives must be set to

- (1) Encourage the disclosure of credible information which is not already available to the government
- (2) Discourage those who seek to profit from these incentives, such as aggrieved former employees of firms who are not whistleblowers.

As the experience of the False Claims Act to be discussed below shows, the setting of these incentives requires considerable fine tuning.

The foregoing discussion underwrites what is necessary to make legislation more efficient. Whistleblowing legislation should proceed in two stages. In the first stage, the emphasis should be on contract design, contract compliance, penalties for non-compliance, and protection of whistleblowers. At the second stage, the question of incentives should be addressed. But before considering this, the FCA is reviewed.

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<sup>7</sup> Depoorter, B. and J. De Mot (2006) Whistle Blowing : An Economic Analysis of the False Claims Act, *Supreme Court Economic Review*.

### 3. The False Claims Act

#### 3.1. History

The False Claims Act was enacted in 1863 to enable individuals to litigate on behalf of the government to prosecute fraudulent claims against the government. The individuals who litigate are whistleblowers who provide the information necessary to prosecute the case. The FCA is then a whistleblowing Act, which both prosecutes fraud and compensates whistleblowers. The FCA was based on the *qui tam* principle originating in 13<sup>th</sup> century England that “he who is as much for the king as for himself”. In modern terms, *qui tam* is a partnership between a whistleblower and the government, and it is the terms of that partnership that determine its effectiveness. The principle of the FCA is to allow individuals to take on the risk of prosecuting those who make false claims against the government, and to be compensated for that risk. The history of the FCA has shown that as individuals are compensated more, so more fraudulent claims are prosecuted. Incentives have been shown to work. After a century and a half of history, the FCA is now regarded as the most effective legislation for combating fraud on the US government.

In the original FCA, those who defrauded the government were fined and compelled to repay the government twice the amount of the fraud. The whistleblowers who prosecuted the case received compensation of 50% of the amount recovered by the government.<sup>8</sup>The FCA remained largely unused until 1942 when a number of parasitic law suits emerged where individuals who saw a defence contractor indicted, immediately filed a *qui tam* action against the contractor. This was against the intent of the FCA which was for whistleblowers to reveal information **that the government did**

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<sup>8</sup> J. B. Helmer (2000) How Great is Thy Bounty: Relator’s Share Calculations Pursuant to the False Claims Act, *University of Cincinnati Law Review*.

**not already possess.** As a consequence, in 1943 the FCA was amended to prohibit any *qui tam* law suit if the government already possessed the information disclosed. But the amendments also reduced the compensation for whistleblowers to a maximum of 10% if the government prosecuted the case. The 1943 amendments emasculated the FCA. The incentives to act on behalf of the government were too low, and the FCA fell into disuse.

The FCA was revived in the 1980s when budget outlays increased by nearly 50% under President Reagan. While the anecdotal evidence of \$400 hammers suggested substantial overcharging, US congressional analysis also suggested fraud on a scale that could not be mitigated under existing legislation. As a consequence, the FCA was amended to increase the incentives for whistleblowers, guarantee compensation to whistleblowers except in special circumstances, introduce protection for whistleblowers, and treble the penalties for fraud. The 1986 FCA amendments are widely regarded as one of the most successful achievements in US legislative history; a before and after comparison demonstrates why. In 1985, the US Department of Justice (DOJ) estimated fraudulent claims against the government to exceed \$50 billion, yet recovered only \$28 million, that is, *less than one-tenth of one percent of the fraud*. Since the 1986 amendments, the DOJ has recovered more than \$28 billion of fraud and *two-thirds of those recoveries are from whistleblower initiated law suits*. In 1988, *qui tam* recoveries amounted to \$2 million. In 2010, they amounted to \$2.4 billion. The history of the FCA has shown that incentives empower whistleblowers, and that all taxpayers, except the fraudulent, are the beneficiaries.

### 3.2. How Does the False Claims Act Work?

The FCA protects the government from paying more than it should for the goods and services it purchases from private contractors.<sup>9</sup>The FCA is based on claims defined against the government. A claim refers to any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, where the United States government provides any portion of the money or property requested or demanded.<sup>10</sup>A false claim refers to any falsity associated with the claim. In particular for contractors, it includes *knowingly* overcharging on material and labour costs, the use of substandard or unauthorised materials, the failure to follow contract specifications including pre-designated mark ups, and the falsification of progress reports. Section 3729 of the FCA defines the term *knowingly* to mean that a person, with respect to information

- (1) Has actual knowledge of the information;
- (2) Acts in deliberate ignorance of the truth or falsity of the information; or
- (3) Acts in reckless disregard of the truth or falsity of the information.

No proof of specific intent to defraud is required. This becomes important when value for money is to be assessed. Thus, the FCA requires contracts to be tightly specified. The falsity or otherwise of a claim is established relative to that specification.

When a whistleblower files a qui tam complaint, they file in camera to a court and submit a written disclosure of their information to the government. The DOJ must investigate the complaint which remains under seal for at least 60 days. The DOJ can request an extension of the 60 day period and usually does.

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<sup>9</sup> B. Sauer (2010) Deterring False Claims in Government Contracting: Making Consistent Use of 18 U.S.S. Section 287, *Pub. Cont. Law Journal*.

<sup>10</sup> Helmer, J., Lugbill, A. and R. Neff (1994).False Claims Act: Whistleblower Litigation. *The Michie Company Law Publishers. Charlottesville, Virginia*.

The most recent data indicate that for *qui tam* cases filed in the last four years, the average length of time under seal is 13 months. There are three possible outcomes to a *qui tam* action.

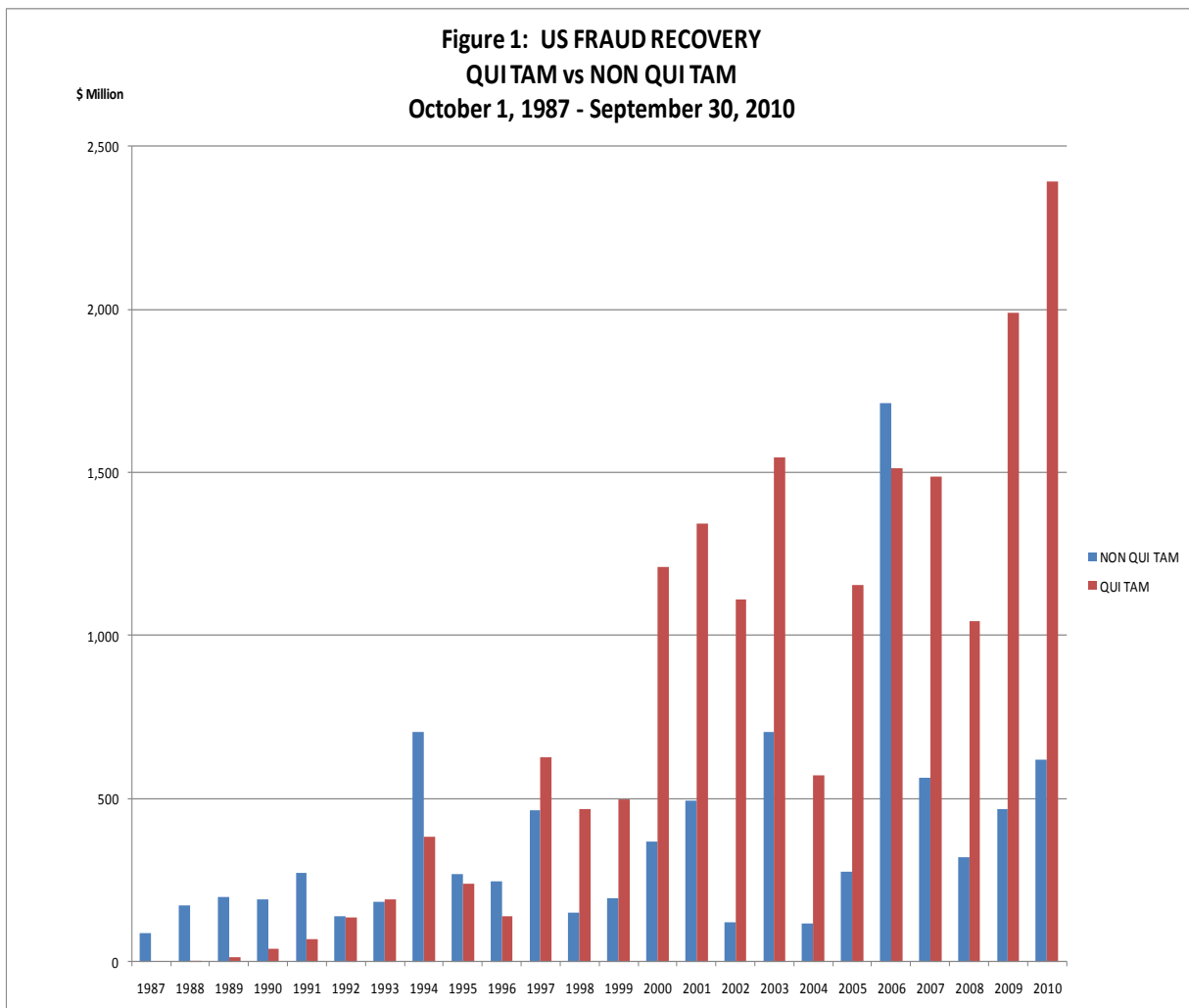
- (1) **If the DOJ intervenes and the action is successful**, the whistleblower is entitled to between 15 and 25 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is not liable for litigation costs. Between 2006 and 2010, the DOJ intervened in only 22% of *qui tam* cases, but still recovered more than \$8 billion which was more than twice what the DOJ recovered in *non-qui tam* jurisdictions.
- (2) **If the DOJ declines to intervene**, the whistleblower may pursue the action on behalf of the government and, if successful, is entitled to between 25 and 30 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is liable for litigation costs.
- (3) **The DOJ may move to dismiss the action** either because there is no case or the case conflicts with statutory or policy interests of the US.

In a successful action, whether the DOJ intervenes or not, the defendant is liable for three times the damages incurred by the government and fines of between \$5,000 and \$10,000 for each fraudulent claim.

The FCA is then a public-private partnership between the government and whistleblowers.

**For the government**, the partnership with whistleblowers confers the following benefits

- (1) The most important tangible benefit of the FCA is the recovery of fraud against the government. *Qui tam* and *non-qui tam* fraud recoveries are shown in Figure 1 below. Since the 1986 amendments, *qui tam* actions have accounted for two-thirds of US government fraud recovered. *Qui tam* actions are increasingly important. By 1991, they amounted to 13.5% of all recoveries, by 1996 for 33% of all recoveries, and in 2008-2010 for 80% of all recoveries. The increasing importance of *qui tam* actions



confirms that the FCA statute is now working as was intended by the amendments of 1986.

- (2) The FCA also confers a substantial intangible benefit as a deterrent against fraud. The value of this deterrence is difficult to estimate. One estimate commissioned by the Taxpayers Against Fraud Center in Washington is that the FCA Amendments of 1986 have deterred more than a hundred billion dollars of fraud. This estimate is supported by Senator Charles Grassley and Representative Howard Berman, the legislators who first proposed the 1986 amendments.

- (3) The FCA is a cost efficient mechanism for recovering fraud. In the health sector, for example, the US government is estimated to be recovering \$15 for every \$1 invested in FCA investigations and prosecutions.
- (4) The FCA encourages better contract design and contract compliance. Written into government contracts is the stipulation that the contract is subject to the provisions of the False Claims Act which represents a strong deterrent to contract violations.
- (5) The existence of precedent *qui tam* cases allows for better determination of future *qui tam* cases, and for better design of future contracts. And *qui tam* cases provide for greater transparency in the recovery of fraud than aggregate statistics.

**For whistleblowers**, the partnership with the government confers the following benefits

- (1) A *qui tam* plaintiff is provided **specific** whistleblower protection against any form of discrimination in the terms of their employment, including restitution to their previous employment status, compensation for any damages resulting from the discrimination and any litigation costs.
- (2) As a civil law statute, the FCA operates under the lowered evidence standard of preponderance of evidence. This is important because financial arrangements and intermediate transactions often render proof of guilt beyond reasonable doubt an onerous burden. The probability of a successful action is increased by the civil statute. There is a provision for criminal actions in Section 287 of the FCA, but it is used relatively little in comparison.
- (3) *Qui tam* actions reverse the *onus of proof*. The plaintiff is the DOJ or the whistleblower, the defendant the false claimant.
- (4) When the DOJ intervenes, the whistleblowers' litigations costs are met by the government. This lowers the litigation risk for the whistleblower. For

whistleblowers, litigation risk is one of the most important factors determining whether they blow the whistle.

- (5) The whistleblower is guaranteed a share of the government's recovery of fraud in a successful prosecution.<sup>11</sup> Payments to *qui tam* plaintiffs average more than 16% of the proceeds of the actions.
- (6) The FCA integrates fraud recovery and whistleblowing. The benefits conferred by whistleblowing become observable. It may be argued that the incentives are too high. But it is hard to argue that \$28 billion of fraud recovery does not underline the value of whistleblowers. The enhancement of the role of whistleblowers is one of the most important consequences of the FCA.

The FCA formalises the partnership between the government and the whistleblower. It is not surprising then that the principles of the FCA have been extended into other jurisdictions. More than 20 states on the United States now have their own False Claims Acts and the recent Dodd-Frank Wall Street Reform Act also has whistleblower incentives.

### **3.3. Case Studies**

Legislation is really only fully understood through cases. The following cases illustrate the recent history of the FCA, and, in particular, the importance of inside information in uncovering false claims against the government, and in prosecuting those false claims. They are sourced from publicly available case material.

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<sup>11</sup> However, a whistleblower convicted of criminal conduct arising from their role in the alleged FCA violation receives none of the proceeds. Also, if the court finds that the prosecution was determined primarily on information other than that provided by the whistleblower, their compensation is limited to 10% of the proceeds.



*Case 1: The State of Iowa v. 78 Pharmaceutical Companies*

*Iowa brought this case in 2007 to recover millions of dollars in damages suffered by Iowa Medicaid Program as a result of defendant drug manufacturers' unlawful pricing practices. Iowa claimed the defendants purposefully reported false and inflated price information for certain prescription drugs. Medicaid was required by Federal Law to reimburse providers at their Estimated Acquisition Cost. Iowa, like all states established a formula to calculate the EAC. There were four pricing benchmarks relevant to the EAC formula: wholesale acquisition cost, average wholesale price, Federal maximum allowable cost, and Iowa maximum allowable cost. The defendants' price reporting activity inflated all four benchmarks. The suit alleged that the price for drugs paid by the State often exceeded 40-50%, 100%, 200% or even 1000% or more of the real prices providers paid for prescription drugs. Iowa alleged that the improper reporting of price information had resulted in overcharges of many millions of dollars to the Iowa Medicaid Program. The first settlement in the case involved eight companies in November 2009 for \$4.3 million.*

*This case illustrated the ability to overcharge and to conceal the overcharging. In the law suit, Iowa maintained that it was well established that "those who seek to be paid from the public purse must **turn square corners**, that is, those who seek public funds can be expected to be held to the most demanding standard in the quest for public funds. In this case, the companies were able to conceal the real prices, often by keeping two sets of books. As Deutsche Bank pharmaceutical analyst Barbara Ryan noted "We all look at list price, because it's the only thing known to us. But list price is increasingly irrelevant. It's more important what goes on behind the curtain." And what went on behind the curtain was revealed by whistleblowers. The practice of keeping two sets of books was verified, for example, by Schering Plough whistleblower Beatrice Manning. The case illustrated that only insiders could uncover the concealment.*

**Case 2: *Pedicone v. Mazak Corporation***

*Pedicone was an accountant who discovered that his employer, Mazak Corporation was importing Japanese-made machine tools, replacing the Japanese labels with “Made in the USA” labels, and then selling the machines to the US Air Force. Pedicone tried to get his employer, and then the US Customs Department, to stop the violations of the Buy American Act. He was unsuccessful and was dismissed. He filed a qui tam action but, after waiting two years for the DOJ to intervene, the Court unsealed the case and Mr Pedicone prosecuted it on behalf of the US. Pedicone incurred the full burden of discovery of documents. Pedicone successfully negotiated a settlement in a non-intervened qui tam case of \$2.39million plus legal costs and whistleblower retaliation charges. The court awarded Pedicone 30% of settlement. The judge noted that “She was impressed with Pedicone’s dogged pursuit of an important matter not vigorously pursued by our Government and the sacrifices Pedicone made, which included losing his job and more.*

**Case 3: *Holzrichter v. Northrop Grumman***

*In 1989, Holzrichter filed a qui tam action that alleged Northrop Grumman, a defence contractor, was overcharging the Government for radar jamming devices installed on Air Force planes. When the DOJ declined to intervene, the qui tam whistleblowers and their counsel continued working the case for the next nine years undertaking extensive discovery, using their own resources. Finally, in 2002, the DOJ intervened in the law suit. The case was settled in 2006 with a \$134 million settlement that would not have been achieved without the dedication of two qui tam whistleblowers and their counsel.*

These cases underscore better than any economic analysis the unique role of whistleblowers in the public-private partnership called the FCA.

### 3.4. Why the False Claims Act Works: The Importance of Incentives

The effect of incentives is demonstrated by a simple example modified from an original example presented by Depoorter and De Mot (*op cit*, p.140). Consider a complaint from a *qui tam* whistleblower alleging fraud of \$1 million on a government contract. Consider three hypothetical scenarios

#### (1) Pre-1986 amendments

In this case, the maximum penalty was 2 times the fraud; if the DOJ intervenes, the whistleblower *may* receive up to 10% of the recovery but with no guarantee; if the DOJ does not intervene, the whistleblower *may* receive up to 25% of the recovery and *may* have litigation costs covered but with no guarantee. If the success rate on litigation is 80% if the DOJ intervenes and 50% if the DOJ does not intervene, the whistleblower receives a **maximum with no certainty** of \$160,000 under intervention, and a **maximum with no certainty** of \$250,000 less 50% of litigation costs if there is no intervention.

#### (2) Post-1986 amendments

In this case, the penalty is 3 times the fraud; if the DOJ intervenes, the whistleblower is *guaranteed* to receive between 15 and 25% of the recovery, if the DOJ does not intervene, the whistleblower is *guaranteed* to receive between 25 and 30% of the recovery including litigation costs. The whistleblower is **guaranteed** to receive \$360,000 under intervention, and **guaranteed** to receive \$375,000 less 50% of litigation costs if there is no intervention.

#### (3) Without an FCA

In the absence of an FCA, litigation typically involves an unfair dismissal or similar claim. If the probability of a successful action is 50%, the net benefit to the whistleblower is 50% of the settlement net of litigation costs.

The expected net benefits under these scenarios are shown in Table 1.

**Table 1  
Net Benefits**

Scenario	Government Benefit	Whistleblower Benefit
<b>Pre-1986 (intervention)</b>	Min \$1,440,000-20%L	Max \$160,000
<b>Post-1986 (intervention)</b>	Max \$2,040,000-20%L	Min \$360,000
<b>Pre-1986 (no intervention)</b>	Min \$875,000	Max \$250,000- 50% L
<b>Post-1986 (no intervention)</b>	Max \$1,225,000	Min \$375,000-50%L
<b>No FCA</b>	0	50% net settlement

L is litigation costs.

When litigation costs are between \$500,000 and \$750,000, under these scenarios, a whistleblower would proceed with an action post-1986, but not pre-1986. This simple example illustrates how incentives work to shift the actions of whistleblowers. When an FCA is not present, the benefit to the whistleblower depends on the damages determined. Typically, the probability of success in such actions is less than the 50% shown here. The whistleblower is substantially better off under a FCA. And, it is also the case that the government is better off, because, in the absence of an FCA, fraud must be recovered by other mechanisms.

The importance of incentives is reflected in a study of US corporate fraud from 1996-2004 by Dyck, Morse and Zingales, *op cit.* who contrast two approaches to fraud detection; the mandatory approach which mandates auditors and other regulators to detect fraud; and the market approach which does not designate *ex ante* those in charge of detecting fraud. They find the market approach accounts for 65% of the detection of frauds they survey and that, in health care, which is subject more closely to the FCA, there is a significantly higher detection by employees (46.7% as compared to the 16.3%

average in other industries). Furthermore, they find that the FCA incentives are not too strong. There are less frivolous law suits in health care than other industries.

A more formal assessment of the FCA incentives was provided by Stringer<sup>12</sup> who asserted that the net benefit from committing a fraud is given by

$$\text{Net benefit from fraud} = E(\text{monetary benefit}) - \text{Pr}(\text{detection}) * (\text{penalty if detected}) \quad (2)$$

where  $E(x)$  represents the expected value of  $x$  and  $\text{Pr}$  is the probability of detection **perceived** by the perpetrator. Amendments to the FCA in 1986 increased the **perceived** probability of detection because it

- (1) Increased the number of persons who can detect and act on fraud.
- (2) Provided increased incentives for those persons to act on that detection.

In addition, the amendments to the FCA in 1986 increased the penalty from 2 times the fraud to three times the fraud. Increasing the perceived probability of detection, and increasing the penalty if detected, both increased the perceived risk for the perpetrators of fraud after 1986. The FCA then has a substantial deterrent effect on fraud. As a consequence, the FCA has two effects on fraud

- (1) A direct effect in terms of fraud recovery
- (2) An indirect effect in terms of the deterrence of fraud.

The direct effect is measured by the fraud recoveries shown in Figure 1. Fraud recoveries since the 1986 amendments to the FCA total \$28 billion, of which \$19 billion have been generated by *qui tam* actions. The indirect effect of deterrence of fraud is more difficult to measure. Fraud itself is an intangible, and the deterrence of fraud must be estimated using assumptions that are not testable. Stringer assumes that the perceived risks of detection are generated by evidence of detection and prosecution,

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<sup>12</sup> W. Stringer (1996) The 1986 False Claims Act Amendments: An Assessment of Economic Impact, *An Economic Study Commissioned by Taxpayers Against Fraud, The False Claims Act Legal Center.*

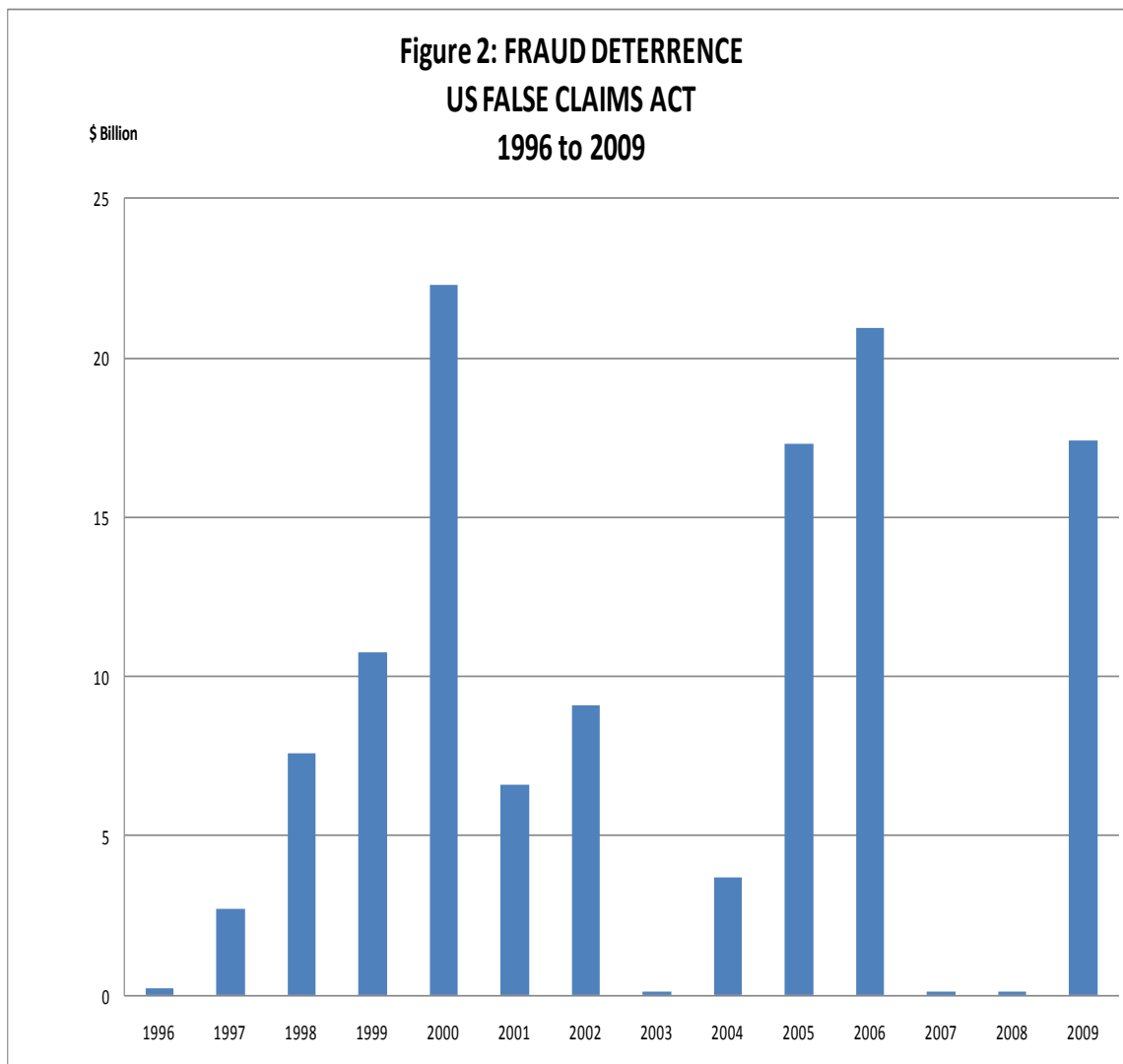
namely recoveries. To simulate the deterrence effect of the FCA, Stringer defines two parameters

- (1) An elasticity of deterrence which is the response of actual fraud to changes in recoveries.
- (2) A decay factor, which is the rate at which the deterrent effect of any given year subsides in the following years.

Stringer assumes an elasticity of deterrence of  $\frac{1}{4}$ ; that is, each one percent increase in recoveries leads to a  $\frac{1}{4}\%$  decrease in actual fraud. He further assumes that the deterrence effect declines linearly for four years until it is zero (straight-line depreciation). Under these assumptions, Stringer shows that the cumulative deterrent effects up to 1996 of the FCA are \$148 billion. In Figure 2, using the same assumptions as Stringer, but with the benefit of updated data on fraud recovery, the deterrent effects of the FCA since 1996 are graphed. The cumulative deterrent effect from 1996 until 2010 is estimated to be \$118.6 billion.

The estimated deterrent effects underwrite the observations of Senator Charles Grassley and Representative Howard Berman, the two original proponents of the 1986 amendments

*“Studies estimate the fraud deterred thus far by the qui tam provisions runs into the hundreds of billions of dollars. Instead of encouraging or rewarding a culture of deceit, corporations now spend substantial sums on sophisticated and meaningful compliance programs. That change in the corporate culture-and in the values-based decisions that ordinary Americans make daily in the workplace-may be the law’s most durable legacy.”*



The FCA establishes a credible deterrent to overcharging, to fraud and, more generally, to non-compliance. Changing a culture of non-compliance into a culture of compliance is one of the most important implications of the FCA; and one of the most important reasons why other countries should adopt their own FCA.

## 4. Australian Whistleblowing Reform

### 4.1. Review of Australian Whistleblowing Legislation

There are *Whistleblower Protection Acts* or *Public Interest Disclosure Acts* in all Australian states and territories. Public interest disclosures in the Federal jurisdiction are represented in the *Public Service Act 1999* (Section 16), the *Workplace Relations Act 1996*, and the *Criminal Code Act 1995*; and balanced against restrictions on disclosures in the *Crimes Act 1914*, the *Privacy Act 1988* and the *Freedom of Information Act 1982*. There are two important benchmarks for Australian legislation contained in two reports. These reports are

- *In the Public Interest*, Senate Select Committee on Public Interest Whistleblowing Report 1994
- *Whistleblowing Protection*, House of Representatives Standing Committee on Legal and Constitutional Affairs Report on Whistleblowing Protection Within the Australian Government Public Sector 2009

In March 2010, the Australian Government responded to the 2009 Report, by announcing proposed federal legislation in the 2011 autumn sitting of the Australian parliament. The main questions that these reports and the government's response seek to answer are

- (1) Who should be able to disclose
- (2) To whom should they be able to disclose
- (3) What matters can be disclosed
- (4) What process of disclosure should be used
- (5) How can those who disclose be protected
- (6) How can disclosures be assessed

Table 2 summarises the two reports and the Australian government response to the 2009 House Committee's *Whistleblowing Protection* Report.



Table 2: Summary of the recommendations of the 1994 Senate Committee, the 2009 House of Representatives Committee, and the 2010 Australian Government Response.

	<b>1994 Senate Committee</b> <i>In the Public Interest</i>	<b>2009 House Committee</b> <i>Whistleblowing Protection</i>	<b>Government Response</b>
<b>Who can disclose</b>	Widest coverage possible in both the public and private sector.	Public sector employees Contractors, consultants Former employees Anonymous persons	<b>Agreed</b>
<b>Who can receive</b>	Public Disclosure Agency Ombudsman Commonwealth regulators Reserve Bank <b>Media</b> if belief that referral to other agencies is futile or will result in victimisation.	Ombudsman APS Commission Merit Protection Commission Other Commissions <b>Media</b> after internal, external referrals and matter not acted on.	<b>Agreed in Principle and</b> National Audit Office Federal Police Human Rights Commission <b>Media</b> after internal, external referrals and matter not acted on.
<b>Matters disclosed</b>	Illegality, fraudulent or corrupt conduct Gross waste of public funds Risk to health and safety Risk to environment Substantial misconduct	Illegal activity Breach of public trust Wastage of public funds Risk to health and safety, Risk to environment Official misconduct Retaliation	<b>Agreed in Principle depending on</b> (1) Seriousness (2) Context (3) Consequence (4) Systemic problem?
<b>Process of disclosure</b>	PID as clearing house for complaints and allegations (1) Investigation (2) Non-disclosures (3) Confidentiality (4) Inform discloser (5) No anonymous disclosures	(1) Investigation (2) Assess risks to whistleblower (3) Confidentiality (4) Inform discloser of progress (5) Separate disclosure from personal grievance	<b>Agreed in Principle and</b> (1) Inform ombudsman (2) Determine seriousness (3) Investigate if serious (4) If not serious, inform (5) Uncover information (6) Assess risks to Discloser.
<b>Whistleblower Protection</b>	Tort of victimisation Merit Protection Agency Human Rights Commission Exemption from sanctions Immunity from liability  Confidentiality	Workplace right Workplace Ombudsman  Immunity from criminal and civil liability  Confidentiality Retaliatory provision in Act	<b>Not Agreed</b> Protection to be determined  Limit immunity for those whose participation may attract other liability <b>Agreed</b> <b>Agreed</b>
<b>Assessment of process</b>	Public Interest Disclosure Board Maintain files, statistics, records of cases Client satisfaction Report to Parliament	Standards Education Anonymous advice line Receive data on use and performance Report to Parliament	<b>Agreed in Principle</b>

Table 2 exemplifies the findings of most comparative studies of Australian whistleblowing.<sup>13</sup> While there is almost universal agreement in Australia that legislation to protect whistleblowers is necessary, there remains uncertainty as to a preferred model. In particular

- (i) There is no uniformity in laws across the state, territory and Federal jurisdictions; each jurisdiction affords different procedures and protections to different types of whistleblowers.
- (ii) No legislation is regarded as uniformly better than any other legislation.
- (iii) All legislation has been framed as a reaction to past whistleblowing cases, rather than as a pre-emptive strategy for future cases.

The emphasis on the ex-post rather than the ex-ante has meant that Australia has not developed a strategy on whistleblowing which integrates whistleblowing with the deterrence of corruption and the recovery of the proceeds of corruption.

There is limited evidence as to the effectiveness of whistleblowing legislation and procedures in Australia. In *Whistleblowing Protection (2008, p7)*, data from the Australian Public Service Commission is provided on whistleblowing in the Federal public sector.

- From 1998 to 2008, the Commissioner received 138 reports of alleged breaches of the APS code of conduct, 17 of which were considered to be public interest disclosures and, of those, only 5 were valid whistleblowing reports.
- During the same period, the Merit Protection Commission received 37 reports, none of which were regarded as public interest disclosures.

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<sup>13</sup> See, for example Bowden, P (2006) A Comparative Analysis of Whistleblower Protections, *Australian Journal of Professional and Applied Ethics*.

- The APS Commission's report for 2009-2010 concluded that the number of employees investigated for suspected misconduct as a result of a whistleblower report comprised about 1% of all employees investigated.

However, the Commission's report for 2009-2010 indicates that suspected breaches of the APS code of conduct were identified by work colleagues (22%), complaints from members of the public/stakeholders (12%), and other (4%). This is more consistent with studies in other countries which show the increasing importance of employees and other stakeholders in revealing anomalies. Such disclosures are usually designated as whistleblowing. Indeed, the commission itself has alluded in the past to this misclassification. As noted in *Whistleblowing Protection (2008, p9)*, the Commission in its 2003-4 report found that many breaches of suspected misconduct are not correctly identified and treated as whistleblower reports.

Griffith University's *Whistle While They Work Project*<sup>14</sup> offers some further insights. The project's cross-sectional survey of 7663 public servants and 118 public agencies provided statistics about an average hypothetical whistleblowing experience

- One quarter of public interest whistleblowers reported reprisals or mistreatment
- Seventy percent of respondents (whistleblowers and non-whistleblowers) had directly observed at least one wrongdoing in a range of nominated examples.
- Only three percent of agencies were rated as having reasonably strong whistleblowing procedures against the relevant Australian standard.

The *Whistle While They Work Project* is a snapshot of Australian public sector whistleblowing which reveals more than the statistics from the APS Commission. However, it too does not fully represent the state of play for four reasons

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<sup>14</sup> *Whistleblowing Protection (2008, p7)*

- (1) The study did not survey whistleblowers who had left the public service as a result of reprisals.
- (2) Whistleblowing is a long-term problem, not captured in a snapshot. Public disclosures often take years to be resolved. In the United States, for example, many False Claims lawsuits have taken more than ten years to be successfully prosecuted.
- (3) The study did not survey other stakeholders, such as contractors, sub-contractors and members of the public.
- (4) There was no cost-benefit analysis of public disclosures.

The APS Commission data and the *Whistle While They Work Project* reveal that

- Whistleblowing in the public sector tends to be underestimated.
- Existing data is uninformative as to both the nature of complaints, the cost of complaints, the protection afforded to complainants, and the benefits of the complaints to the government.
- Complaint mechanisms do not extend to other stakeholders such as contractors, sub-contractors and members of the public.

The Australian government's proposed whistleblowing legislation is contained in their response of March 2010. This response can be benchmarked against other legislation, in particular the FCA. The response suggests that the proposed whistleblowing legislation does not have the coverage or the detail to apply to most public-private partnerships. As a consequence, it lacks the ability to deter overcharging or to recover the wastage of public funds. The following issues are relevant

1. The proposed legislation would extend coverage to contractors, sub-contractors and their employees, but not to other complainants. Any person who discloses

credible information in the public interest should be protected by whistleblowing legislation.

2. The proposed legislation refers to wastage of public funds as a category covered by the legislation. But, to be useful, wastage of public funds must be calibrated against an appropriate *value for money* benchmark written into government contracts.
3. The proposed legislation refers to breach of public trust and illegal activity as a category covered by the legislation. But this is not sufficiently specific to capture the possibility of firms that do not deliver value for money. If breach of trust were defined to refer to compliance with the terms of a contract or sub-contract where the government provides some of the funds, any falsification would then constitute a breach of trust.
4. The proposed legislation is silent on how contracts are subject to the proposed legislation. To be effective, the terms of every contract where the government provides funds should include the condition that the contract is subject to whistleblowing law.
5. The type of information required to fully identify wastage of public funds requires insiders to reveal whether contractors are charging different rates on government projects from that charged on similar projects where government funds are not being used. The proposed whistleblowing legislation is unlikely to provide sufficient incentives to provide this information. An efficient whistleblowing scheme would elicit such disclosures.

An efficient whistleblowing scheme must

- (1) Encourage, not just protect, insiders to reveal information
- (2) Encourage the recovery of wasted public funds

There is no provision in the Australian government's proposed legislation to either of these objectives.

## 4.2. An Alternative Proposal for Australian Whistleblowing Legislation

Australia's whistleblowing laws could readily be strengthened to make them more robust to violations in government contracts. Modifications could proceed in two stages, without incentives and with incentives. Legislation would then encompass all contracts with the Commonwealth of Australia. Possible modifications of the Australian government's response of 2010 are as follows

### **Recommendation 1**

*The purpose and principles of the Public Interest Disclosure Bill should reflect the following:*

- *The purpose of the Bill is to promote accountability, integrity and **efficiency** in public administration.*
- *The principal purpose is to protect those who disclose in the public interest, to deter non-compliance in contracting with the government, and to encourage the recovery of the proceeds of non-compliance in contracting with the government.*

### **Recommendation 2**

*All Australian residents, and all who contract with or have contracted with the Commonwealth, regardless of residency, are entitled to make a protected disclosure.*

### **Recommendation 3**

*The Public Interest Disclosure Bill provides that an integrity agency be responsible for coordinating public disclosures and, in particular, the protection of those making disclosures, the measurement of non-compliance in contracts with the Commonwealth, the deterrence of non-compliance and the recovery of the proceeds of non-compliance.*

### **Recommendation 4**

*A claim refers to any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, where the Commonwealth provides any portion of the money or property requested or demanded.*

**Recommendation 5**

*Contracts with the Australian government should include a value for money clause which*

- (i) Defines the value for money benchmark prescribed by the Commonwealth.*
- (ii) Prescribes the requirement that the contract will be calibrated against this value for money benchmark.*
- (iii) Prescribes that the contract is subject to the Public Interest Disclosure Bill.*

**Recommendation 6**

*A false claim refers to any claim on the Commonwealth which is knowingly false, meaning*

- (i) knowingly failing to calibrate against a value for money benchmark; or*
- (ii) knowingly overcharging on materials, labour costs and mark-ups; or*
- (iii) failure to follow contract specifications including the use of substandard or unauthorised materials, improper specifications or the falsification of progress reports; or*
- (iv) failure to exercise due diligence in project supervision.*

*Knowingly is defined to mean that a person, with respect to information*

- (i) Has actual knowledge of the information;*
- (ii) Acts in deliberate ignorance of the truth or falsity of the information; or*
- (iii) Acts in reckless disregard of the truth or falsity of the information.*

**Recommendation 7**

*Protected disclosures include, but are not limited to serious matters related to*

- Illegal activity*
- False claims*
- Wastage of public funds*
- Breach of public trust*
- Risk to health and safety and to the environment*
- Official misconduct*
- Retaliation against those who make public disclosures*

These recommendations are designed to

- (1) Focus on the information, not those who inform.
- (2) Specify more precisely the terms of contracts with the Commonwealth.
- (3) Specify more precisely non-compliance.
- (4) Increase the deterrence to non-compliance.

The intent of specifying legislation more precisely in terms of compliance and non-compliance is to lower the costs of prosecution, to increase the probability of prosecution, and to increase the deterrent effect of given prosecutions; thereby rendering the market for compliance more efficient. But efficiency can also be increased by considering incentives, which are discussed in the section below.

#### **4.3. An Australian False Claims Act**

Given the US experience and the realisation that incentives to blow the whistle do work, Australia should now consider both incentives for those who disclose false claims, and penalties for those who claim falsely on the Commonwealth. Because Australia has no history of false claims actions, and because the principle of paying whistleblowers is new, the penalties and incentives may have to be lower than in the United States. However, the penalties and incentives cannot be too low. Otherwise, fraud recovery and deterrence will be restricted.

An Australian False Claims Act (a *qui tam* Act) could follow the US model, so that a complainant can file in camera to a court and submit a written disclosure of their information to the integrity agency. The integrity agency must investigate the complaint which remains under seal for a prescribed minimum period. The integrity agency can request an extension of the period. An example of an incentive structure is given below



- (1) **If the integrity agency intervenes and the action is successful**, the whistleblower is entitled to between 10 and 15 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is not liable for litigation costs.
- (2) **If the integrity agency declines to intervene**, the whistleblower may pursue the action on behalf of the government and, if successful, is entitled to between 15 and 20 percent of the proceeds of the action or settlement of the claim. If the action is unsuccessful, the whistleblower is liable for litigation costs.
- (3) **The integrity agency may move to dismiss the action** either because there is no case or the case conflicts with statutory or policy interests of the Commonwealth.

In a successful action, whether the integrity agency intervenes or not, the defendant is liable for twice the damages incurred by the Commonwealth and a maximum fine of \$5,000 for each fraudulent claim. The protection of whistleblowers could be analogous to that provided by the US False Claims Act. Any employee who is discriminated against in the terms and conditions of employment by their employer because of a *qui tam* action shall be entitled to all relief necessary to make the employee whole, including reinstatement with the same seniority status, back pay, and compensation for any special damages sustained.

In Table 3, the new proposals above are compared with the Australian Government Response of March 2010. The new proposals impart efficiency to by

- (1) **Lowering the cost of prosecution**, attributable to a lower burden of proof for prosecuting those who falsely claim against the Commonwealth.
- (2) **Increasing the probability of prosecution**, due to better compliance specifications and wider detection using whistleblowers.
- (3) **Increasing deterrence**, because of the greater likelihood of prosecution and the enhanced role of whistleblowers.

**Table 3: A Comparison of the 2010 Government Response and New Proposals which include an Australian False Claims Act**

	<b>2010 Government Response</b>	<b>New Proposals</b>
<b>Who can disclose</b>	Public sector employees Contractors, consultants Former employees Anonymous persons	All Australian residents All who have contracted with the government, regardless of residency.
<b>Who can receive</b>	Ombudsman APS Commission Merit Protection Commission Other Commissions <b>Media</b> after internal, external referrals and matter not acted on.	Integrity Agency Courts APS Commission Merit Protection Commission <b>Media</b> after internal, external referrals and matter not acted on.
<b>Matters disclosed</b>	<i>Depending on seriousness</i> Illegal activity Breach of public trust Wastage of public funds Risk to health and safety, Risk to environment Official misconduct Retaliation	Illegal activity False Claim Breach of public trust Wastage of public funds Risk to health and safety, Risk to environment Official misconduct Retaliation
<b>Process of disclosure</b>	(1) Investigate if serious (2) Assess risks to whistleblower (3) Confidentiality (4) Inform discloser of progress (5) Uncover information (6) Separate disclosure from personal grievance.	As for Government Response <b>and for False Claims Act litigants:</b> File in court and submit to Integrity Agency Litigation with Agency intervention or Litigation without Agency intervention Settlement, court decision or dismissal.
<b>Whistleblower Protection</b>	Protections to be determined Limit immunity for those whose participation may attract other liability Confidentiality Retaliatory provision in Act	As for Government Response <b>and for False Claims Act litigants:</b> Specific Protections in False Claims Act No litigation costs if Agency intervenes <i>Qui tam</i> payments
<b>Assessment of process</b>	Standards Education Anonymous advice line Receive data on use and performance Report to Parliament	As for Government Response <b>and for False Claims actions</b> Court decisions and precedent cases Fraud recoveries <i>Qui tam</i> payments

#### **4.4. A Brief Analysis of an Australian False Claims Act**

Analogous to the analysis in Section 3.4 for the US FCA, we estimate the projected direct and indirect effects of an Australian FCA from 2010-11 until 2020-21. In order to estimate the direct effects, we require assumptions as to

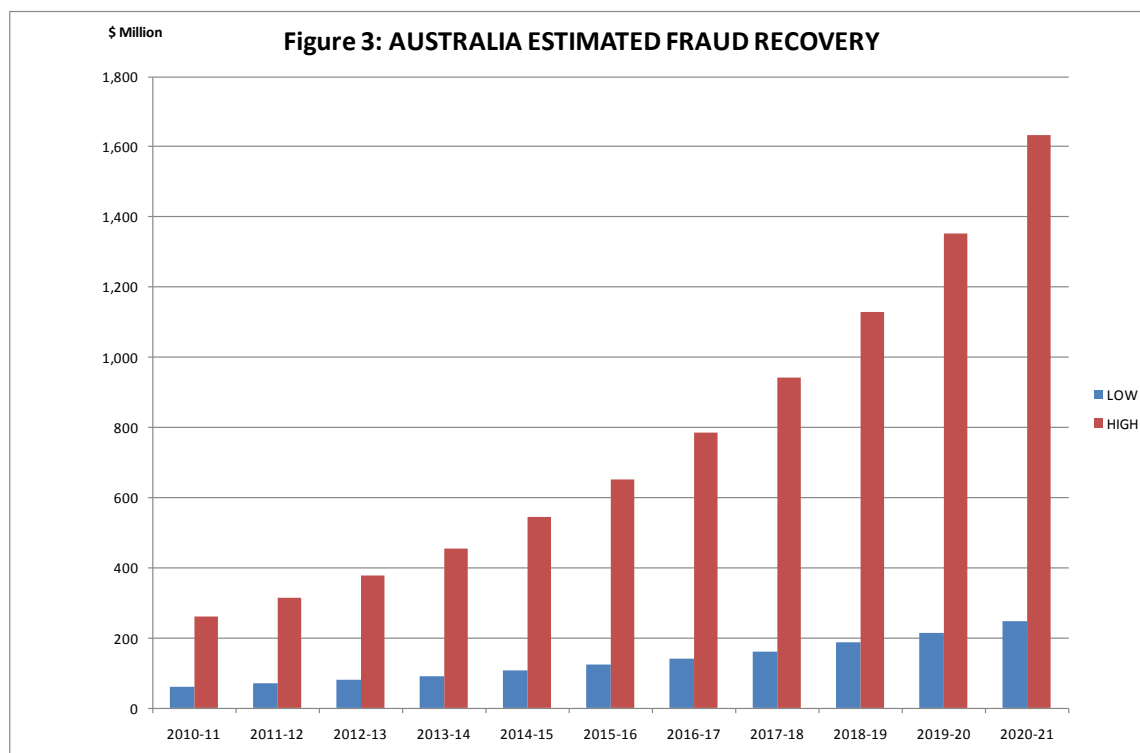
- (1) An estimate of the value of false claims on Commonwealth outlays in 2010-11.
- (2) An estimate of the growth rate in the value of false claims from 2010-11 to 2020-21.
- (3) The base recovery rate using a FCA.
- (4) The growth rate in recoveries.

The value of false claims in 2010-11 is estimated from Commonwealth outlays of \$352 billion. A typical assumption for the percentage of false claims ranges from 1 percent to 10 percent.<sup>15</sup> Surveys of international fraud find that large corporations are typically exposed to a fraud risk of 5 percent on revenues. As a consequence, two possibilities are considered for the base estimate of fraud in 2010-11, namely 1 percent of Commonwealth outlays and 5 percent of Commonwealth outlays. A conservative assumption of a 3 percent annual growth rate in fraud is used for the period 2010-11 to 2020-21. This is below most estimates, but is sufficient to illustrate the direct effects. For the base recovery rate, two assumptions are used; 0.35% in the base year which is consistent with the recovery rate in the first three years of the US FCA after the amendments and 1.5% which is the recovery rate in the second decade US FCA after the amendments. Finally the growth rate in recoveries is assumed to have two values, 15% and 20% which are consistent with the growth rate in US recoveries from 1986 to 2010. These four sets of assumptions generate eight scenarios for fraud recovery from 2010-11 to 2020-21. The lowest recovery scenario corresponds to fraud amounting to 1% of

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<sup>15</sup> This is the assumption that the DOJ originally used in testifying to the House Appropriations Subcommittee in 1980.

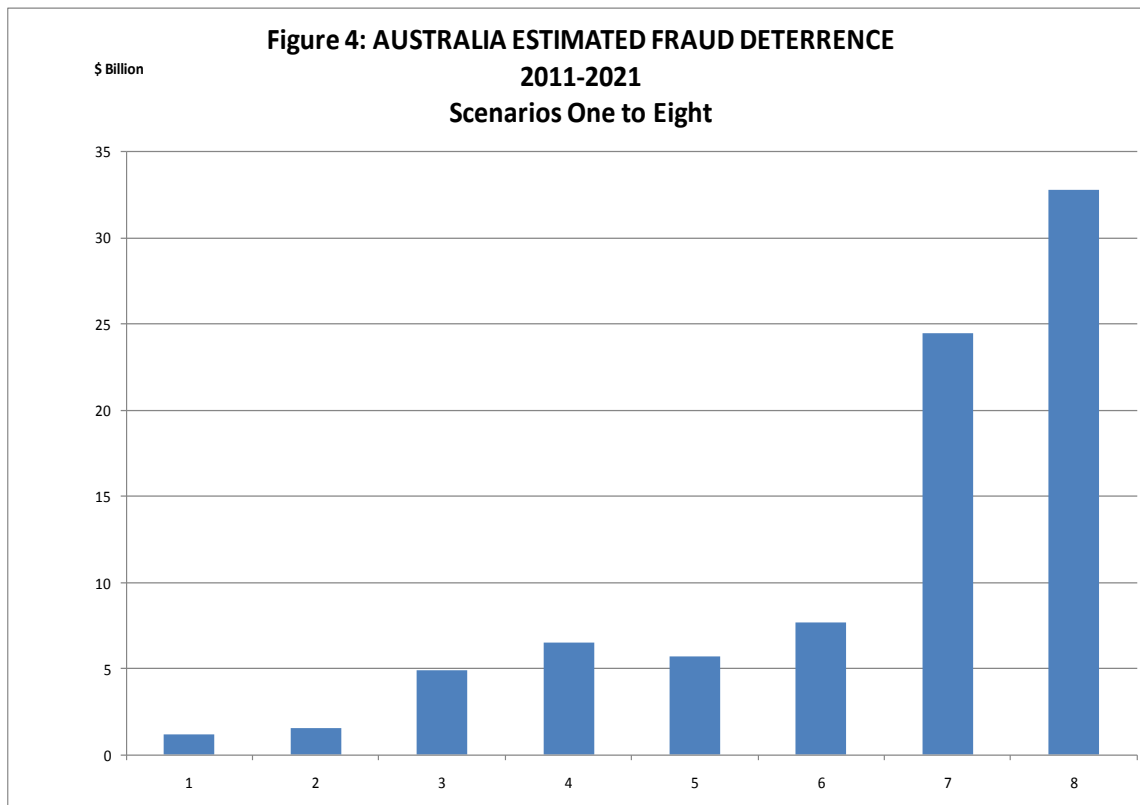
Commonwealth outlays, a base rate of recovery of 0.35%, and a growth rate in recoveries of 15%. The highest recovery scenario corresponds to fraud amounting to 5% of Commonwealth outlays, a base rate of recovery of 1.5%, and a growth rate in recoveries of 20%. The recovery of fraud from these low and high scenarios is presented in Figure 3.



Under these assumptions, cumulative fraud recovery over the decade ranges from a low estimate of \$300 million to a high of \$8.5 billion. The cumulative recovery exceeds \$1 billion in six of the eight scenarios and, given the US experience, this would appear to be a reasonable expectation for the fraud recovered in the next decade if the FCA were implemented now.

To estimate the deterrent effect, similar assumptions are employed as in Section 3.4. The elasticity of deterrence which is the response of actual fraud to changes in recoveries is assumed to be  $\frac{1}{4}$ ; that is, each one percent increase in recoveries leads to a  $\frac{1}{4}$ % decrease

in actual fraud. The deterrence effect for each increase in recoveries is assumed to decline linearly for four years until it is zero (straight-line depreciation). The estimated deterrent effects for the eight scenarios of fraud recovery are presented in Figure 4.



Under these assumptions, cumulative deterrence of fraud over the decade ranges from a low estimate of \$1 billion to a high exceeding \$30 billion. The implications for future government expenditure are threefold. Because of the risk of a false claims action, a FCA encourages contractors to comply with contract specifications, to achieve value for money against contract benchmarks, and for contract managers to ensure contracts are fulfilled. A FCA is then an insurance policy for a culture of compliance. Most importantly, it would permit Australian whistleblowers the opportunity to show the real benefits of the public-private partnership called whistleblowing.

## **5. Concluding Remarks**

Legislation constitutes more than establishing a framework for penalising wrongdoing; it can also be seen as creating a market of incentives and disincentives which form a market of compliance. Like any market, it is the efficiency of this market that is most relevant. A compliance market with no prosecutions is like a financial market with no liquidity; it is highly inefficient. Australian whistleblowing legislation is of this form. There have been no prosecutions for retaliation against whistleblowers and, as a consequence, there is little deterrence against retaliation and other wrongdoing; and little incentive to blow the whistle.

Whistleblowing is a particular type of public-private partnership which, when structured appropriately, can be beneficial to both the Commonwealth and to whistleblowers. The analysis in this paper has suggested modifications to Australian whistleblowing law based on a two stage approach. First, it is proposed that legislation should be widened to focus on the information disclosed rather than who discloses that information; to make the determination of the matters disclosed more specific and aligned to contracts with the Commonwealth; and to encourage a culture of compliance where whistleblowing legislation is written into every contract. Secondly, it is proposed that false claimants on the Commonwealth should be penalised and whistleblowers incentivised to reveal previously unknown information. The projections of recovery of the proceeds of false claims and the deterrent effects are similar to the projections made by the proponents of the United States FCA in the 1990s, projections which have subsequently been realised. All that is required is the acceptance that if whistleblowers are to be the market regulators who act on behalf of the citizens, they should be compensated for the risk and the costs that they bear.