"Does it Pay to Blow the Whistle?" – Update on Sarbanes-Oxley and *Qui tam*

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After the shareholder and employee debacles at Enron and WorldCom, Time Magazine named three whistle-blowers as its persons of the year. This seemed surprising to many of us who live and work in a culture that prizes loyalty. Did the whistle-blowers' new found stature mark a pronounced shift in the public's/jury member's perception of these curious people? For the trial lawyer contemplating a jury, one man's whistle-blower is another man's "tattle-tale." But did the general public's disgust with corporate fraud create a paradigm shift? Probably not, but the emergence of *qui tam* lawsuits and Sarbanes-Oxley claims has given employees more leverage.

There is no doubt that our capitalist economy could benefit from a good ethical scrub. Occupational frauds translate to approximately $660 billion in total losses to the US Gross Domestic Product.[1] But what is more interesting is that occupational frauds are much more likely to be detected by a tip than through other means such as internal and external audits. Among frauds committed by owners and executives, over half of all cases were identified by a tip.[2]

But, there is a high personal price to pay by coming forward. "It's the exception that a whistle-blower is looking to get even, because it's very painful to break ranks with [your company], even if [you] have strong legal rights."[3] Once whistle-blowers come forward, they establish a reputation as a trouble-maker and their employability suffers. Most employment applications now include questions about litigation and whether or not an employee is eligible for "rehire" -- the new blackball code words in the employment market. And for those of us who try employment cases, plaintiffs who blow the whistle are attacked as crack-pots, disgruntled trouble-makers who couldn't do the work.

Nevertheless, in this "pull yourself up by your boot straps" jury mentality, the story of the lone employee standing up for what is right may now resonate, as the stories of race and gender discrimination fall by the wayside as "whining" and employment issues of the past.

Aside from the Sabine Pilot exception to the employment-at-will doctrine that protects employees who get fired for refusing to commit crimes,[4] Sarbanes-Oxley creates an emerging cause of action for employees retaliated against for blowing the whistle on

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[1] 2004 Report to the Nation on Occupational Fraud and Abuse, Association of Certified Fraud Examiners at iii.

[2] *See id.*

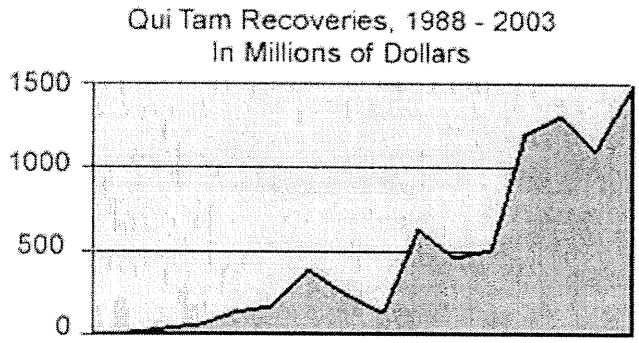
[3] Alix Nyberg, *Whistle-Blower Woes*, CFO MAGAZINE, Oct. 2003 (quoting Thomas Devine).

[4] *See Sabine Pilot Serv., Inc. v. Hauck*, 687 S.W.2d 733, 735 (Tex. 1985). Of the four *Sabine Pilot* cases tried in Dallas County, plaintiffs were successful in two of them, or 50%. The awards were $9,354,504 and $26,586. However, in Tarrant County, Plaintiffs lost both of the cases tried in that county. (Analysis of trial reports, Kilgore & Kilgore.)

corporate fraud in public companies. There has also been an explosive growth in *qui tam* claims.

***Qui tam*: The Overlooked Employment Issue.**

The federal False Claims Act ("FCA") was originally passed in the Civil War era and substantially updated by amendments in 1986. Known as "Lincoln's Law," it was enacted to address a rash of fraud against the government. Essentially, if a private citizen blows the whistle on a company defrauding the government resulting in the recovery of money by the government, the citizen can receive a sizeable reward. Since 1986 the federal government has recovered just over $12 billion from false claim submissions, and Texas has recovered approximately $5 million.[5] In 2004, the relators' share of the awards was $108,571,026.[6] The chart below shows *qui tam* recoveries.[7]



The False Claims Act, or *qui tam*, suit is tricky. It involves the employee or relators providing the government with a written disclosure "of substantially all material evidence and information possessed so the government has enough information to decide whether it should participate in the filed lawsuit, or allow the relator to proceed alone." Because of the costs of litigation, the trick is to provide the government with enough information to want to take on the case.

The complaint is filed under seal until the government has an opportunity to complete its investigation. While the complaint is under seal the government can elect to join the lawsuit, decline to join the lawsuit, move to dismiss the action, or attempt to settle the action. If the government elects to intervene, the relator can continue to participate in the litigation, but under limited circumstances, which the court has discretion to decide. The FCA provides a relator's share of at least 15 percent of any award if the relator does nothing more than file the lawsuit. Larger awards can be up to 25 percent for relators who actively assist in the investigation.

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[5] Joel M. Androphy and Mark A. Correro, *Federal Qui tam,* HOUSTON LAWYER, January/February 2005, at 19.

[6] http://www.taf.org/statistics.html.

[7] *Id.*

Statistically, the government intervenes in 18 percent of all *qui tam* cases filed. If the government does not intervene, the relator may have the right to proceed on his or her own.

The Supreme Court has held that the FCA was intended to reach all types of fraud, without qualification, that "might result in financial loss to the Government."[8] Three common elements must be proved for a violation of the FCA: (1) a "claim" for money must be presented to the government, (2) the false claim must be made "knowingly," and (3) the claim must be "false" or "fraudulent."[9] *Qui tam* actions commonly arise in the areas of health care, government contracts, and oil and gas royalties.

Beware, the relator must be the original source of the information to recover. The act bars actions based upon information that is "publicly disclosed." Publicly disclosed information is information from congressional, administrative or General Accounting Office reports, or from the news media. In the Fifth Circuit, for the relator to recover, he or she first must demonstrate direct and independent knowledge of the information on which the allegations are based. And second, the relator must demonstrate that he or she voluntarily provided the information to the government before filing.[10] Unfortunately, until it comes time to make the claim for the award, the relator may be working for years on a *qui tam* lawsuit only to find that the award is barred because the information on which the government recovers came from the public, or someone else provided the original information. In one case an executive director of a healthcare system lost her *qui tam* claim, in part because she publicly dislosed the information on which her *qui tam* lawsuit was based in her earlier lawsuit for wrongful termination.[11]

Texas *Qui tam* Whistle-blower Case Examples:

In September 2003, Orthofix, Inc. agreed to pay $1.575 million to settle allegations that it inappropriately billed the TRICARE program, the Department of Defense's healthcare program, by billing for medical devices for uses that were not FDA-approved. [12]

In June 2003, Dey, Inc. agreed to pay $18.5 million to settle a *qui tam* lawsuit. The lawsuit alleged that Dey defrauded the Texas Vendor Drug Program and the

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[8] *United States v. Neifert-White Co.*, 390 U.S. 228, 232 (1968).

[9] 31 U.S.C. § 3729(a) (1994).

[10] *United States ex rel. Laird v. Lockheed Martin Eng'g and Sci. Servs. Co*, 336 F.3d 346, 352 (5th Cir. 2003).

[11] *United States ex rel. Reagan v. East Texas Med. Cent. Reg'l Healthcare Sys.*, 384 F.3d 168, 175-76 (5th Cir. 2004).

[12] *Texas-Based Medical Device Manufacturer to Pay U.S. $1,575,000 to Resolve False Claims Allegations*, Department of Justice, Sept. 16, 2003, www.usdoj.gov.

Texas Medicaid program by billing the programs for drugs at a higher rate than they actually cost.[13]

In October 2002, Pfizer Corporation agreed to pay $49 million to settle a federal *qui tam* lawsuit filed in Texas, alleging that Pfizer fraudulently avoided paying the rebates owed to the states and the federal government under the Medicaid Rebate program for the drug Lipitor.[14]

In May 2001, Driscoll Children's Hospital agreed to pay the government $14.5 million to settle a federal *qui tam* lawsuit filed in Texas, alleging improprieties under the Disproportionate Share Hospital Program for uncompensated care.[15]

In the first quarter of 2001, *qui tam* lawsuits for underpaid oil royalties against Exxon Mobil, Shell Oil Company, Burlington Resources, Marathon Oil Company, Phillips Petroleum and ten other oil companies resulted in recoveries exceeding $415 million.[16]

The only *qui tam* cause of action under Texas statute is the Texas Medicaid Fraud Prevention Act[17], which applies only to Medicaid fraud.

Sarbanes-Oxley Whistle-blower Cases.

The Corporate and Criminal Fraud Accountability Act[18], commonly referred to as the The Sarbanes-Oxley Act ("SOX"), emerged in the post–Enron era to protect against corporate fraud abuses. Section 806 provides a cause of action to employees of publicly traded companies who are retaliated against for reporting what the employee believes to be a violation of "any provision of Federal law relating to fraud against shareholders."

The Department of Labor ("DOL") delegated to the Occupational Safety and Health Administration ("OSHA") enforcement authority over SOX's whistle-blower provisions. Under OSHA regulations, an employee must make a prima facie case of retaliation. The employee must show that: (1) he or she engaged in a protected act, i.e., reporting accounting irregularities, reporting false and misleading information to the shareholders; (2) the employer knew that the act occurred; (3) the employee suffered an unfavorable

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[13] *Pharmaceutical Company, Dey, Inc. to Pay U.S. & Texas $18.5 Million to Settle Allegations of Medicaid Fraud*, Department of Justice, June 11, 2003, www.usdoj.gov.

[14] *Drug Giant Pfizer & Two Subsidiaries to Pay $49 Million for Defrauding Drug Medicaid Rebate Program*, Department of Justice, Oct. 28, 2002, www.usdoj.gov.

[15] *Cornyn, Driscoll Childen's Hospital Reach Accord*, Office of the Attorney General, May 24, 2001.

[16] *Phillips Petroleum Pays $8 Million to Resolve Oil Royalty Claims[.] More than $415 Million Paid to Date by 15 Companies*, Department of Justice, Feb. 9, 2001, www.usdoj.gov.

[17] TEX. HUM. RES. CODE § 36.001 *et seq.*) (Vernon 2001 & Supp. 2004) (Medicaid Only.

[18] 18 U.S.C. § 1514A (Supp. 2005).

personnel action, i.e., alienation, untruthful performance review, demotion, termination; and (4) the circumstances "were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action."[19] But, before a whistle-blower can even get a hearing before an administrative judge, the whistle-blower must demonstrate by a preponderance of the evidence that the protected activity was a contributing factor in the unfavorable action alleged in the complaint. The employer must then demonstrate by clear and convincing evidence that it would have taken the same unfavorable employment action in the absence of the whistle-blower's protected behavior or conduct. The whistle-blower can bring an action for review de novo before a district court if there is no final decision within 180 days of the filing of the complaint. If a decision is made in the whistle-blower's favor, the whistle-blower is entitled to all relief necessary to make himself whole, including: reinstatement, payment of back pay with interest, and compensation for special damages including attorney's fees, expert witness fees, and litigation costs. If the complaint is found to be frivolous or brought in bad faith, the whistle-blower may be liable for attorney's fees up to $1,000.

In the three years since SOX's enactment, most whistle-blower cases have gone the employer's way. Of the 300 charges filed, 230 have reached a determination at the DOL investigative level.[20] Of those cases, approximately 25 percent were either dismissed for lack of merit or voluntarily withdrawn by complainants.[21] Another 27 cases were settled before determination. As of November 2004, eight cases have been decided on the merits. Of those cases, three were decided in favor of the employee and five were decided in favor of the employer.[22]

In one important decision a federal court decided that Sarbanes-Oxley claims are subject to mandatory arbitration.[23] But the DOL has no teeth. It has no subpoena power and no authority to interview witnesses without a company representative present.

Even in the face of these difficult results, the Sarbanes-Oxley claim creates leverage for whistle-blowers. It is no surprise that after William Murray,[24] TXU's former Senior

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[19] 29 C.F.R. § 1980.104(b)(1)(iv)(2005).

[20] *Employers Faring Well in Sarbanes-Oxley Cases*, Orrick, Herrington & Sutcliffe, November 1, 2004.

[21] At least 25% of reported Sarbanes-Oxley whistle-blower cases have been dismissed or withdrawn because employees have taken advantage of the 180-day limit and opted out of the administrative law system and proceeded in federal district court. *Whistleblower Protection Under the Sarbanes-Oxley Act*, WALL STREET LAWYER, October 2004.

[22] The eight cases decided on the merits were *Klopfenstein v. PCC Flow Technologies Holdings, Inc.*, 2004-SOX-11 (ALJ July 6, 2004); *Lerbs v. Buca di Beppo, Inc.*, 2004-SOX-8 (ALJ June 15, 2004); *Harvey v. The Home Depot, Inc.*, 2004-SOX-36 (ALJ May 28, 2004); *Platone v. Atlantic Coast Airlines Holdings, Inc.*, 2003- SOX-27 (ALJ Apr. 30, 2004); *Halloum v. Intel Corp.*, 2003-SOX- 7 (ALJ Mar. 4, 2004); *Getman v. Southwest Securities, Inc.*, 2003-SOX-8 (ALJ Feb. 2, 2004); *Welch v. Cardinal Bankshares Corp.*, 2003-SOX-15 (ALJ Jan. 28, 2004); *and McIntyre v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 2003-SOX-23 (ALJ Jan. 16, 2004).

[23] *Boss v. Salomon Smith Barney, Inc.*, 263 F. Supp. 2d 684, 685 (S.D.N.Y 2003).

Vice-President of Portfolio Management, brought his Sarbanes-Oxley suit for retaliatory termination after reporting unorthodox accounting in August 2002, that TXU announced the settlement of a securities fraud class action for $150 million for a class period beginning on October 1, 2002.[25]

Moreover, an administrative law judge has recently demonstrated the range of remedies. In Welch v. Cardinal Bank Shares[26] the administrative law judge awarded back pay, costs and attorney's fees in addition to reinstatement of the employee, another result that would prove difficult for the employer.

Whistle-blower Cases In The Metroplex

To date, jury results in the Metroplex have not been kind to whistle-blowers. Of the five cases tried in Dallas County involving whistle-blower claims, only one plaintiff was successful, with an award of $1,200. But, of the two cases tried in Tarrant County, plaintiffs were successful in both. One plaintiff was awarded $27,000, while in the other case, four plaintiffs were each awarded amounts between $358,226 and $552,757.

While the results are still mixed, the often overlooked whistle-blower claims under Sarbanes-Oxley and the False Claims Act are growing and clearly create leverage for the employee. Perhaps it is time for employment lawyers to take notice of these trends and recognize a new stature for the whistle-blower.

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[24] *Murray v. TXU Corp. et al.*, No. 3:03CV-0888P, (N.D. Tex. 2003).

[25] Jan, 21, 2005 Public Announcement.

[26] 2003-SOX-15(ALJ Feb 15, 2005).