



AMERICANS FOR TAX REFORM

MEMORANDUM

To: Members of Congress
From: Grover Norquist, President, Americans for Tax Reform
Date: 4/22/05
Re: Medicare/Medicaid Spending & Fraud

This year, both the House and Senate budgets sought to achieve efficiencies in the fastest growing segment of the federal budget – entitlement spending. The idea behind the resulting cost reductions was not to cut services, but rather, to identify waste, fraud, and abuse and make the programs more efficient. Despite the widespread waste in these programs, many members are still reluctant to take on these cost savings.

Yet, a new column by Stephen Moore, president of the Free Enterprise Fund, shows one area where a program was put into place to combat fraud and is actually encouraging more fraud and increasing the cost of the programs to American taxpayers. By changing the incentives of the program, Congress can reform a broken system, generate much needed savings for the federal budget and become a major tort reform initiative. As such, reform of this broken system is a top priority for Americans for Tax Reform.

Key Points:

- The main vehicle for the government to attack fraud in contracting for services is the False Claims Act. 1986 reforms increased the use of this provision by allowing whistleblowers to file lawsuits against their employers on behalf of the government.
- While the use of whistleblowers may be productive in some cases, since the 1986 revisions, recoveries have become a billion dollar business involving more than 4000 cases.
- Why? Because the 1986 law allows whistleblowers to reap mountainous windfall rewards of 15 to 30 percent of the eventual financial penalty or settlement.
- As such, the pendulum has swung too far and is now actually encouraging wrong-doing. **For sure it is providing incentive not to report bad acts to employers. Instead those witnessing these acts have the lucrative financial incentive to let them fester and then report it government prosecutors or private lawyers who in return can reap tens of millions of dollars from the litigation.**
- **Published reports document how some whistleblowers, instead of reporting problems to their companies have spent months gathering evidence; some have even been caught stretching the truth in the hopes of a big payday.** If they had just reported the problem it could have been fixed. Instead all the incentive is to keep it quiet and look for a big payout.

- **Companies that do not agree these exorbitant settlements face the possibility of *debarment*, of being prevented from doing business with the government again if found guilty.** No company, regardless of its size can take this risk. So Prosecutors use this as a sword over the heads of these companies to force them into huge settlements. In 2003, whistleblowers were paid \$319 million dollars from these settlements.
- **The enormity of these settlements drives trial lawyer firms to engage in ambulance chasing for whistle-blowers.** Some of these firms even advertise the size of the settlements that whistleblowers have shared in as a way to encourage hiding problems until a evidence can be gathered and a law suit filed.
- **The settlements from these suits and actions do nothing but line the pockets of trial lawyers, whistle-blowers and the coffers of government.** There are no assurances or documentation that the money goes back to fix the system that was the source of the complaint in the first place.

Congress should take on three specific reforms to fix the False Claims Act as put forward by Stephen Moore:

1. To be eligible for an award, a whistleblower should be required to have made documented efforts to remedy rather than perpetuate fraud within the company. Fines could be increased for anti-retaliation actions by companies.
2. The rewards and legal fees for whistleblowers and their attorneys should be capped at a reasonable level of \$1 million, so as to end the bounty hunter mentality.
3. When money is recovered by the government in fraud cases it should be returned to the specific government agency that was defrauded, not to the DOJ's enforcement budget or the U.S. treasury. With Medicare and Medicaid costs running out of control, it's common sense that the funds these programs were defrauded of should be returned to them.



Blowing the Whistle on Jackpot Justice

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By Stephen Moore and Phil Kerpen

Fighting financial mismanagement and fraud throughout the agencies of the federal government is an urgent mission if we ever hope to rebalance the budget. The Office of Management and Budget recently found that the Medicare program made \$21.7 billion in improper payments to doctors, hospitals and insurers in 2004. Medicaid, with its overlapping state and federal roles, also has rampant fraudulent claims. Unfortunately, the government's efforts at combating erroneous payments are pitifully ineffective, thus encouraging more fraud, fueling medical inflation, and ripping off tens of billions of dollars from taxpayers.

The primary vehicle for attacking fraud in government contracting is the False Claims Act, legislation that dates back to the Civil War when it was used to prevent defense contractors from selling the government bad gunpowder. The law, substantially beefed up in 1986, authorizes workers, i.e., whistleblowers, to file lawsuits against their employers on behalf of the government. The Department of Justice may then join in the lawsuit and initiate a fraud investigation.

This is all well and good except for the fact that the 1986 law allows whistleblowers to reap mountainous windfall rewards of 15% to 30% of the eventual financial penalty or settlement. This allows whistleblowers to enrich themselves with tens of millions of reward money. Two of the most famous jackpot award winners in recent years were David Franklin, who was paid \$24.6 million for blowing the whistle on Pfizer, and Doug Durand, recently profiled in *Forbes*, who has received a whopping \$173 million for whistleblowing against two different medical companies.

In this compulsive get-rich-quick society, whistleblowing has now become a rapid growth industry in America with employees, enticed by the quick route to fabulous wealth, becoming parasitic on site snoopers against their employers.

The theory behind paying rewards to whistleblowers makes sense: without the conscientious employee exposing wrong doing, taxpayers may never have recovered a dime of the fraudulent payments involved in these cases. But these super-jackpot rewards dangling in front of employees eyes are in many cases having exactly the opposite impact as hoped for. They prevent companies from early detection and correction of erroneous billing practices.

Here's why: there's a powerful incentive for an employee who uncovers improprieties, which may be inadvertent or unknown to upper management, to secretly collect evidence and then go to a lawyer, rather than stopping the fraud early and inside the company. Whistleblowers often quietly collect evidence for months while fraud continues.

Lawyers are also getting rich off the whistleblower awards and can walk away with tens of millions of dollars for each successful case. The U.S. attorneys also make money for the Department of Justice with successful prosecutions and finds, so they doggedly pursue these charges -- fair or not. And since contractors are essentially barred from any further federal grants or contracts if they are found guilty of a fraud charge, even innocent firms often rush to settle -- writing the settlement penalty off as a cost of doing business with Uncle Sam -- rather than face even the remote prospect of a judgment that puts them out of business. The scales of justice have become heavily weighted against the accused, rather than the accuser.

Perversely, the whistleblower rules have arguably increased industry-wide costs and tend to increase medical prices, the opposite of the enforcement's intended effect.

The Bush administration has tried to curb some of the excesses of the False Claims Act by requiring whistleblowers to agree voluntarily to moderate curbs on their awards; not surprisingly that effort has failed.

We believe there are a number of steps that should be taken by Congress to reform the False Claims Act to protect the accused, lower the huge legal bills, and avoid fraud before it happens. First, to be eligible for an award, a whistleblower should be required to have made documented efforts to remedy rather than perpetuate fraud within the company. Fines could be increased for anti-retaliation actions by companies.

Second, the rewards and legal fees for whistleblowers and their attorneys should be capped at a reasonable level of \$1 million, so as to end the bounty hunter mentality.

Finally, when money is recovered by the government in fraud cases it should be returned to the specific government agency that was defrauded, not to the DOJ's enforcement budget or the U.S. treasury. With Medicare and Medicaid costs running out of control, it's common sense that the funds these programs were defrauded of should be returned to them.

In many ways the federal government is plagued with worse financial mismanagement than Enron or WorldCom ever had. Financial fraud, which is a form of theft from taxpayers, must be swiftly and severely penalized. Whistleblowers should be rewarded for exposing these financial scams. But Congress should realize that ultimately the jackpot justice of eight and even nine figure dollar awards to whistleblowers come out of the wallets of pockets of the taxpayers -- who the whistleblowers are supposed to be protecting.

Stephen Moore is president of the Free Enterprise Fund and a senior fellow at the Cato Institute. Phil Kerpen is policy director at the Free Enterprise Fund.