Is A Whistleblower Incentive Program Right for Canada?

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3/12/2010

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Introduction

On February 10, 2004, "Auditor General Sheila Fraser's report revealed the federal government had mismanaged hundreds of millions of taxpayer dollars between 1997 and 2001" (CBC News Online, 2006). On February 24, 2004, Olympic gold medalist Myriam Bédard alleged that she was forced out of her job at Via Rail after she questioned some transactions related to the Sponsorship Scandal (CBC News Online, 2006). The Sponsorship Scandal and the related allegations of whistleblowers being silenced prompted the Canadian federal government to consider and implement significant legislative reforms such as the Federal Accountability Act to protect whistleblowers and deter potential fraud in the future. One of the possible reforms considered by the Conservatives was to introduce whistleblower incentive legislation similar to the False Claims Act (FCA) in the U.S. (May, 2006). This paper will first provide a brief background on the False Claims Act and explain why introducing similar legislation in Canada is worthy of consideration. Then, it will analyze the potential financial costs and benefits of implementing FCA-like legislation in Canada. Finally, it will explore the ethical implications of such legislation. By analyzing the financial and ethical implications, this paper aims to determine whether introducing FCA-like legislation would be good public policy in Canada.

What is the False Claims Act?

The False Claims Act (FCA) was first introduced in the United States in 1863 to combat fraud by government contractors during the American Civil War (Lewis, 2000). It contains a whistleblower-incentive component that rewards private citizens for reporting fraud committed by government contractors (Lewis, 2000). This whistleblower-incentive component is the focus of this paper. The False Claims Act was amended in 1986 to increase its scope and create greater

incentives for whistleblowers (Lewis, 2000). In its current form, if a private citizen suspects that a contractor is defrauding the government, the private citizen, also known as the relator, can bring his/her allegation to the Department of Justice (DoJ) in what is referred to as a Qui Tam case (Lewis, 2000). The DoJ then investigates the allegation and decides whether to pursue the case (Lewis, 2000). If the DoJ declines to intervene, the private citizen can sue on the government's behalf (Lewis, 2000). In any case, if the suit is successful, a substantial portion of the reward or settlement (15-30% depending on the relator's contribution to the case) is awarded to the relator (Lewis, 2000)..

Why is FCA-like legislation relevant in Canada?

The two main reasons why FCA-like legislation is worthy of consideration for Canada are the absence of private-sector whistleblower legislation in Canada and the success of the FCA in the United States. According to the Treasury Board of Canada (2009), the Canadian federal government spent approximately $15 billion on private-sector contracts in 2007. Due to the federal government's economic stimulus spending during our current recession, this figure is expected to be even larger in 2009. It is vitally important that this money is spent wisely. Thus, the absence of private-sector whistleblower legislation represents a missed opportunity for the Canadian government to catch and deter fraud in this area.

The success of the FCA in the U.S. makes it a good model to consider for private-sector whistleblower legislation in Canada. Between 2000 and 2008, the U.S. government has regularly recovered over $1 billion per year from whistleblower-initiated FCA cases (U.S. Department of Justice, 2008). In 2007, the U.S. government recovered approximately $1.44 billion ($1.26 billion net of payment to relators) from $458 billion of spending on private contractors (U.S.

Department of Justice, 2008) (OMB Watch, 2009). If we assume that government contract fraud occurs with a similar frequency in Canada, the Canadian government could have recovered approximately $47 million[1] ($42 million[2] net of payment to relators) from $15 billion of spending on private contractors in 2007 through a FCA-like legislation. To put this into perspective, the Canadian government could pay the university tuitions for 10,000 undergraduate students for a year with $42 million[3]. So it is worthwhile to consider whistleblower incentive legislation that might help the government catch existing fraud and deter future fraud.

This paper aims to examine the potential consequences for Canada of adopting legislation with the same scope and similar mechanism of enforcement as the whistleblower incentive component of the FCA. Because of the structural differences between the Canadian and U.S. governments, a successful implementation of FCA-like legislation in Canada should leverage existing Canadian government apparatus such as the Auditor General and the Public Prosecution Service of Canada. A full discussion on the implementation of FCA-like legislation in Canada is beyond the scope of this paper.

Financial Benefits and Costs

Introducing FCA-like legislation in Canada is expected to bring significant financial benefit to the Canadian government in the forms of damages recovered from fraud and deterrence of potential fraud. Introducing such legislation is also expected to create additional costs for both the government and private sector contractors. To compare the potential financial benefits and

[1] 1.44 billion / 458 billion * 15 billion = 47 million
[2] 1.26 billion / 458 billion * 15 billion = 42 million
[3] According to StatCan (2006), university students pay on average $4347 for tuitions in the 2006/2007 academic year.

costs of introducing FCA-like legislation in Canada, this paper will first estimate the benefits and costs of the FCA to the U.S. between 1997 and 2001. The financial benefit data is largely derived from the U.S. DoJ's False Claims Act Statistics (2008), and the financial cost analysis is based largely on Carson's 2008 study. Then this paper will forecast the benefits and costs of introducing similar legislation in Canada in a year like 2007 assuming that both benefits and costs will scale with government spending on private contractors. This cost-benefit analysis is summarized in tabular form in Appendix A. Based on this analysis, it is expected that FCA-like legislation would provide a net financial benefit to Canada. While this analysis does not fully account for the differences between Canada and the U.S., one can see in Appendix A that there is a large allowable margin for error in determining whether FCA-like legislation would be financially beneficial to Canada.

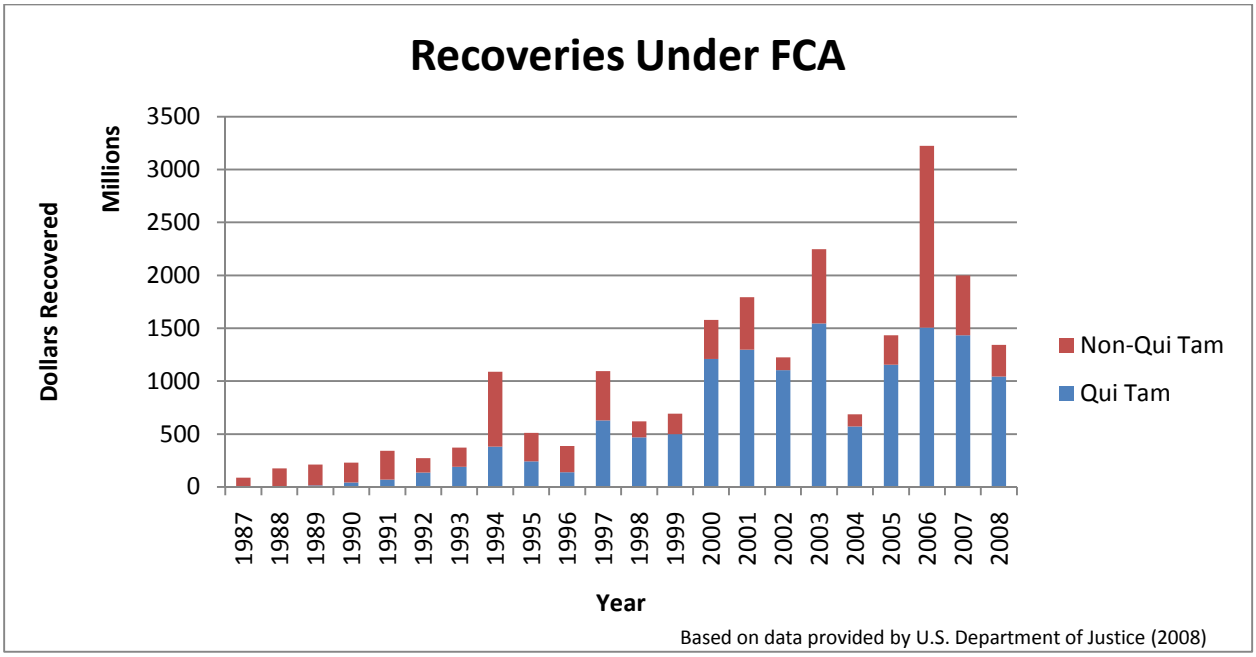
Benefits

Introducing FCA-like legislation in Canada is expected to bring two main benefits: it will help the Canadian government catch and recover damages from existing fraud and it will help deter potential fraud.

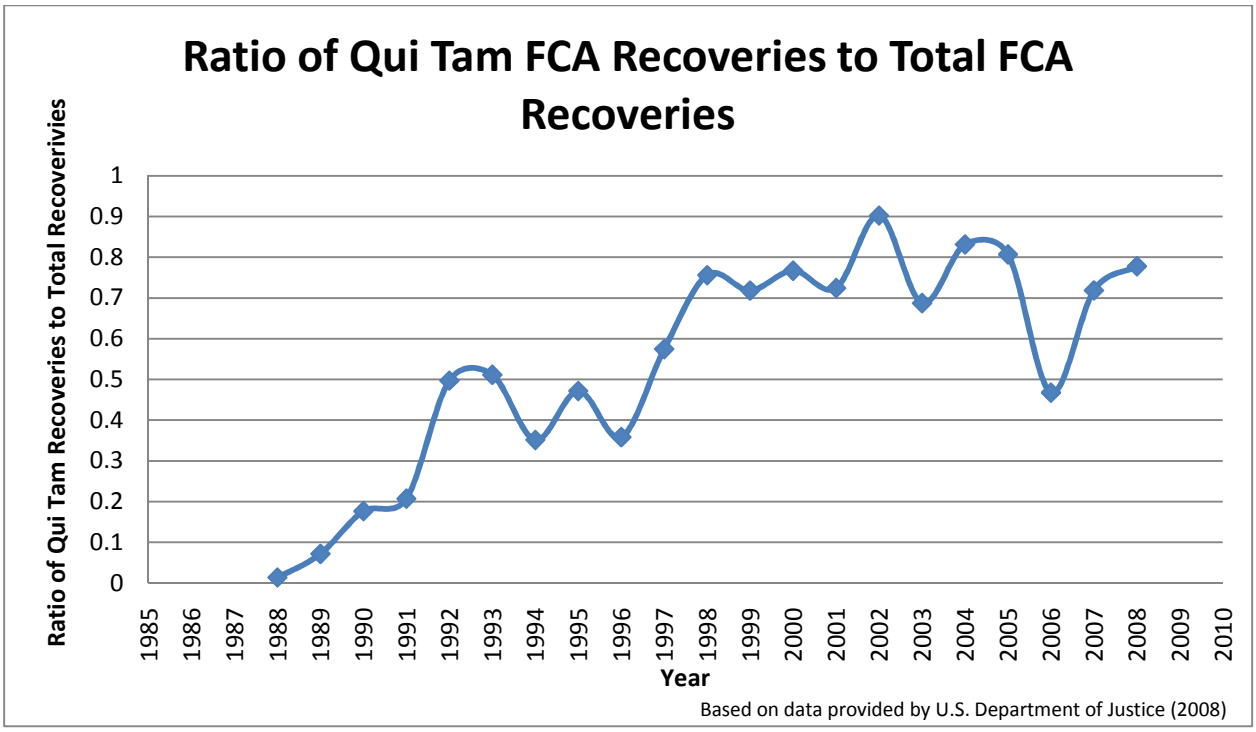
To estimate the damages the Canadian government could potentially recover from fraud through FCA-like legislation, it is useful to look at the historical data in the U.S. Since it was amended in 1986, the FCA has been an indisputable success in the U.S. in terms of damages recovered. According to the U.S. Department of Justice (2008), between 1986 and 2008, the U.S. government has recovered over $13 billion ($12 billion net of payment to relators) from whistleblower-initiated FCA cases. This represents approximately 60% of the total recoveries of $22 billion from both whistleblower-initiated and government-initiated FCA cases between 1987

and 2008. As illustrated by the graphs below, between 2000 and 2008, the U.S. government has regularly recovered $1 billion or more per year through FCA Qui Tam. Therefore, it is reasonable to conclude that FCA Qui Tam is a valuable tool for the U.S. government in its fight against fraud and similar legislation could become a valuable tool for Canada.

For the period considered (1997-2001), the U.S. government recovered $4.1 billion ($3.5 billion net of payment to relators) through FCA Qui Tam cases from $1 trillion of spending on private contractors (U.S. Department of Justice, 2008) (OMB Watch, 2009). If recoveries scale with total government spending on private sector contractors, Canada could have recovered over $62 million[4] ($52 million[5] net of payment to relators) through a FCA-like legislation in 2007.



[4] 4.1 billion / 1 trillion * 15 billion = 62 million.
[5] 3.5 billion / 1 trillion * 15 billion = 52 million.



One of the reasons why the FCA has been so effective in the U.S. is that the financial incentives it offers have motivated private citizens to provide a wealth of high quality information to the government. This makes it financially worthwhile for the U.S. government to investigate and pursue the cases brought to its attention. According to U.S. Department of Justice (2008), between 1987 and 2008, 6199 cases were brought to its attention by private citizens and it chose to intervene in 1190 of these cases (19% intervention rate). Out of the 1190 cases, 1000 have been judged or settled in favour of the government, 52 have been dismissed and 138 remain active (a 95% success rate). This high success rate suggests that the U.S. government probably chose to pursue only the most promising cases with high probability of success and large potential payout. If Canada could obtain similar quality of information through a FCA-like legislation, it could become an invaluable source of information for Canada in its fight against fraud.

In addition to helping the government uncover fraud and recover damages, introducing FCA-like legislation in Canada can also help deter potential fraud. Carson (2008) and Daniels (1995) argue that the FCA gives government contractors a strong incentive to avoid overbilling the government (whether through fraud or honest mistake) for fear of being reported. There is evidence to suggest that the 1986 amendment to the FCA encouraged companies to place a higher emphasis on internal controls to avoid overbilling the government. According to Ruhnka (2000), the 1986 amendment to the FCA coincided with significant increase in the number of Fortune 500 companies adopting or updating their official Codes of Conduct. Today, the FCA remains at the top of the U.S. corporate consciousness. This is evidenced by the numerous articles in industry publications advising government contractors to adopt rigorous internal controls to avoid overbilling the government and reduce the risk of FCA lawsuits (see (Blair, 2008), (Mattie, 2009) (Lankenau, 2004), (Spevak, 2006)). While the deterrence benefit is hard to quantify, Carson (2008) asserts that it should be greater than the actual recoveries under FCA. If Canada chooses to introduce FCA-like legislation, it is reasonable to expect that Canada could achieve similar deterrence effect.

Costs

Introducing FCA-like legislation in Canada is expected to create significant costs for the Canadian government and private contractors. The main financial costs are expected to be the resources that the government devotes to pursuing cases brought to its attention, the cost of false/baseless allegations to private contractors and the conflicts such legislation may have with voluntary compliance and disclosure programs. The following cost analysis draws heavily from Carson's 2008 analysis of the historical costs of the FCA in the U.S.

To realize the benefits of FCA-like legislation in Canada, the Canadian government must devote the necessary resources to investigate and pursue credible cases brought forward by private individuals. If the legislation is designed in an efficient way to take advantage of the existing government apparatus in Canada, it is reasonable to expect that this cost will scale with the fewer expected cases of fraud in Canada. Carson (2008) estimated the total cost for the U.S. government to investigate all whistleblower-initiated FCA cases and intervene in legitimate cases between 1997 and 2001 to be $310 million. Carson based his estimates on Meyer (2003)'s analysis on the U.S. government's spending and recovery on healthcare fraud under the FCA. Carson (2008) noted that Meyer prepared his report for Taxpayers Against Fraud (an advocacy group for the FCA) so the estimate is likely biased downwards. However, even if this figure is doubled or tripled, the total benefit of the FCA still outweighs its total costs (see Appendix A). Assuming that this cost scales with total government spending on private contractors, the Canadian government would have to spend approximately $5 million to investigate and pursue alleged cases of wrong-doing in 2007 under a FCA-like legislation.

By providing a financial incentive for private citizens to bring forth claims of wrongdoing, critics of the FCA argue that introducing FCA-like legislation would cause an increase in false/baseless allegations. To estimate the potential cost of the false/baseless allegations to Canada, it is useful to look at the U.S. historical data. However, it is reasonable to expect this cost to be much lower in Canada because of the differences between the Canadian and American legal systems. Under the Canadian legal system, the loser could be liable to pay for part or all of the winner's legal costs. This means that if a private citizen brings a false/baseless case to the government and the government declines to intervene, the private citizen is unlikely to risk his/her personal wealth to pursue the case further.

The two main costs of false/baseless allegations are the government's costs to investigate these cases and the private contractors' costs to defend against these cases. The cost to the U.S. government to investigate false/baseless cases is included in our estimate of the U.S government's total cost of $310 million to pursue all cases between 1997 and 2001. Carson (2008) estimated the cost of false/baseless cases to U.S. corporations between 1997 and 2001 to be $792 million. In making this estimate, Carson made the following assumptions: all of the 2211 dismissed FCA Qui Tam cases between 1987 and 2001 were baseless and each baseless case costs the corporation approximately $400,000 to defend (1987 dollars). Carson's estimate for number of false/baseless cases is conservative. It is reasonable to believe that not all dismissed cases were false/baseless. In fact, the U.S. DoJ's high success rate in the cases it chose to pursue (95%) suggests that it may be choosing to pursue only the most promising cases. Carson's estimate for the average per-case cost to corporations is also conservative because he based it on a 1986 estimate made by Yang and France (1987), who were critics of the FCA. Based on the above assumptions, Carson estimated the cost of false/baseless allegations to corporations between 1987 and 2001 to be $884 million ($1.3 billion adjusted for inflation) which translates to an inflation-adjusted cost of $792 million between 1997 and 2001. If this cost scales with total government spending on private contractors, the cost of false/baseless allegations under a FCA-like legislation to private contractors in Canada would have been $12 million in 2007[6].

Some critics of the FCA argue that the FCA conflicts with voluntary compliance and disclosure programs that are designed to encourage corporations to implement internal controls to minimize the likelihood of fraud and to self-report when fraud does happen (Ruhnka J. C., 2000). The

[6] $792 million / $1 trillion * 15 billion = 12 million

interaction between the FCA and voluntary compliance and disclosure programs is complex. Proponents of the FCA argue that it complements voluntary compliance programs by creating a greater incentive for companies to catch, correct and voluntarily disclose their own mistakes to avoid FCA lawsuits (Daniels, 1995). As previously discussed, there is some evidence to support this argument.

Opponents of the FCA argue that the FCA reduces the effectiveness of voluntary compliance programs for two main reasons. Firstly, critics of FCA argue that the FCA creates a disincentive for companies to set up better internal controls because problems uncovered through internal controls could be used to sue the company (Ruhnka J. C., 2000). This is a valid criticism of the FCA. If Canadian legislators plan to introduce similar legislation in Canada, they should ensure that corporations that have demonstrated due diligence in their voluntary compliance activities could partially mitigate their legal liability. This will ensure that corporations will have an incentive to implement strong internal controls. Secondly, critics of the FCA argue that the FCA gives employees an incentive to circumvent the internal reporting systems so that they can report externally for profit (Ruhnka J. C., 2000). To address this concern, the Canadian version of the FCA should give courts the discretion, as is the case in the U.S., to reduce a whistleblower's reward when it is apparent that the whistleblowers had intentionally obstructed internal controls for personal gain. Also, it is important to recognize that a person mercenary enough to obstruct internal controls for personal gain would probably not have reported the wrong-doing at all without a financial reward (Carson, 2008). So the damage to the public would likely be greater without the FCA. Based on the above analysis, it is clear that the main conflicts between FCA-like legislation and voluntary compliance programs can be partially mitigated by fine-tuning the

legislation. Furthermore, the author of this paper believes that this cost is more than offset by the FCA's fraud deterrence benefit.

Ethical Implications:

In determining whether a FCA-like legislation in Canada is good public policy, it is important to evaluate its ethical implications. Financially rewarding whistleblowers raises many serious ethical questions. The following issues are discussed and addressed in this paper: the perceived or actual tainting of whistleblower's motives, the ethicality of rewarding whistleblowers who were complicit in the wrongdoing and the ethicality of rewarding employees who did not report to their employer first. Critics of the FCA also contend that the FCA encourages false/baseless allegations and gives potential whistleblowers a perverse incentive to delay reporting so as to maximize their reward. These behavioural implications are also discussed and addressed.

Tainting Whistleblower Motives

There is a public perception that whistle-blowing should be done for the right reasons and not for financial gain. In 2006, when the Canadian parliament was considering the Conservatives' plan to reward bureaucratic whistleblowers $1000 for uncovering wrongdoing, Edward Keyserlingk, Canada's public service integrity commissioner, testified before parliament that "it's a kind of motivation I would hope we don't have to appeal to." (Ditchburn, 2006) It is easy to understand Mr. Keyserlingk's concern. A glance at the headlines in the U.S. shows that the financial reward offered by the FCA has motivated some decidedly unpleasant behaviour by whistleblowers such as disputing how their award should be shared with an AIDS foundation (Armstrong, 2005).

The perceived or actual tainting of whistleblower motives by a financial reward has been debated in the ethics literature. Some authors place paramount importance on the motive for whistle-blowing. Grant (2002) argues that "any indication that reward was anticipated, or in any way entered into the decision to blow the whistle, compromises the ethical quality of the act itself." On the other side, some authors argue that motive is irrelevant when considering the whistle-blowing action it inspires. Bouville (2008) argues that Grant and others' preoccupation with motives is fallacious: "What do you think of someone who reflects 'what I am about to do is wrong because I would be saving lives for the wrong reasons' and decides not to act?". Carson (2008) argues that if people blow the whistle on real fraud for amoral or even immoral reasons such as greed or malice the act itself is nonetheless good. Carson based his argument on John Stuart Mills' assertion that "motive has nothing to do with the morality of the action, but much to do with the worth of the agent." Bouville (2008) further argues that because of the great personal costs of whistle-blowing we should not expect ordinary people to blow the whistle simply out of altruism just as we would not expect most people to sell all their property and donate the proceeds to African children. Most potential whistleblowers need a large reward to compensate them for taking the personal risk of whistle-blowing, and the FCA provides such a reward. After evaluating both sides of the argument, the author of this paper agrees that it is indeed preferable to have whistleblowers report on fraud without a thought for personal gain. However, if one is to choose between a whistleblower reporting a fraud out of personal interest or not at all, then it is preferable to have a whistleblower blowing the whistle for personal gain.

Rewarding Whistleblowers Complicit in the Wrongdoing

Many Canadians may object to rewarding "insider" whistleblowers who were complicit in the wrongdoing. For example, Lissak, an investment banker previously involved in illegal bond

underwriting schemes, received millions under the FCA for revealing how investment banks used such schemes to cheat municipal bond issuers (Gasparino, 1999). It may feel ethically dubious to reward someone who was involved in the wrongdoing. However, sometimes they are the people in the best position to report a fraud as Lissack states "These are things I know how to find ... Remember, you're talking to somebody who did all of these deals." (Hume, 2007)

Daniels (1995) provides a very good analysis of whether a whistleblower incentive program should reward whistleblowers who were complicit in the wrongdoing. He concluded that the FCA's approach of allowing the courts to set the reward for whistleblowers that were complicit in the wrongdoing is sometimes politically unpalatable but socially desirable. On one hand, Daniels argues that rewarding whistleblowers despite their complicity may motivate some employees to corrupt their coworkers into engaging in wrong-doing so that they can blow the whistle for profit. However the potential reward for reporting under FCA is likely to sow distrust among the wrongdoers and cause such schemes to collapse. On the other hand, Daniels argues that rewarding "insider" whistleblowers despite their complicity is ultimately good for the public because "insider" whistleblowers are often the only people who can stop a fraud. Daniels also argues that such a reward promotes the public good by encouraging the morally weak or corrupt employees to report wrongdoing out of self-interest when such wrongdoing could have gone undetected without the FCA.

Rewarding Whistleblowers Who Did Not Go to Their Employers First

There is a perception of disloyalty when whistleblowers go directly to the public without reporting to their employers first and giving their employer an opportunity to voluntarily correct their mistake or fraud. To address this issue, it is useful to categorize these whistleblowers into

two groups: those who do not report internally for fear of retaliation and those who cover up wrongdoing to maximize their own reward. In each case, it can be shown that the FCA ultimately promotes the public good. For whistleblowers who do not report internally for fear of retaliation, while their actions may seem disloyal their fears are well justified. As Carson (2008) argues, whistleblowers who report internally run the risk of retaliation and the wrongdoing being covered up. Ultimately, it is socially desirable to have these whistleblowers report the wrong-doing to some authority and the FCA offers them a relative safe way to do it. Furthermore, the public discomfort with employees who do not report to their employers first stems partially from the perception that it is preferable for companies to correct their wrongdoing voluntarily (Ruhnka J. C., 2000). However, according to Carson (2008) and Daniels (1995), internal whistle-blowing may not be in the public's best interest: a corporation might correct an internally reported problem but choose to not inform the government so the public could go uncompensated. For the case of whistleblowers who intentionally cover up wrongdoing to maximize their own reward, Carson (2008) argues that such individuals are so "mercenary and selfish" that they would not have reported the wrong-doing at all without the FCA. So the FCA serves the public interest by inducing such individuals to report wrong-doing.

Encouraging False/Baseless Allegations

Critics of the FCA claim that the FCA encourages disgruntled employees and "bounty hunters" to make false/baseless allegations against honest businesses (Blair, 2008). However, research has not shown a link between the FCA and a significant increase in frivolous lawsuits (Dyck, 2009). There are good reasons why the FCA has not encouraged excessive frivolous lawsuits. According to Carson (2008), a whistleblower making false allegations risks being found guilty of perjury. This provides a strong disincentive for making false/baseless allegations. Also if a

whistleblower does not bring credible evidence to the government, the government has the discretion to not pursue the case (Carson, 2008). If the government declines, few whistleblowers have the will and resources to pursue a baseless case (Ruhnka J. C., 2000).

Encouraging those aware of wrongdoing to delay reporting

Some critics of the FCA argue that the FCA presents potential whistleblowers with a perverse incentive to delay whistle-blowing. A whistleblower's reward is based on the damage recovered so it is in his financial interest to delay reporting so as to maximize the damage (Ruhnka J. C., 1998). There is some evidence in the media to suggest that some whistleblowers might have delayed reporting. For example, in 1993, the DoJ tried to reduce a whistleblower's reward because it suspected that the whistleblower had delayed reporting to increase damages recovered (Naj, 1993). However, there are often legitimate reasons for whistleblowers to delay reporting. According to Carson (2008) and Daniels (1995), whistleblowers often need the time to make sure that fraud is actually taking place, build up sufficient evidence and, in some cases, give the company a chance to correct the issue internally. According to Carson (2008) and Lewis (2000), FCA also presents whistleblowers with an incentive to report quickly before another whistleblower does and takes the reward. Furthermore, Carson (2008) argues that a whistleblower selfish enough to intentionally delay reporting would not have reported at all without the FCA. In this case, it is better that he blew the whistle late rather than never. After assessing the competing incentives, the author of this paper believes that the FCA is likely to induce more timely reporting.

Conclusion:

In the aftermath of the Sponsorship Scandal, many whistleblower protection and fraud prevention legislative reforms were considered and implemented. One of the options considered was introducing legislation similar to the False Claims Act to Canada. To determine whether this would be good public policy in Canada, the merits of such legislation is evaluated on its financial and ethical dimensions. This paper first assessed the potential financial costs and benefits of introducing FCA-like legislation to Canada. This analysis, as summarized in Appendix A, shows that introducing FCA-like legislation in Canada is expected to produce a net financial benefit. The paper then discussed the ethical implications of introducing an incentive-based whistleblower program in Canada. This analysis showed that introducing a FCA-like legislation will raise many serious ethical questions. However, introducing such legislation will generally serve the public interest. Based on these considerations, the author believes that introducing a FCA-like program in Canada will be good public policy.

Appendix A: Summary of Cost-Benefit Analysis:

Based on the cost-benefit analysis, the financial benefits and costs of the FCA to the U.S. in 1997-2001 are estimated to be:

Table 1 – Estimated Cost & Benefit of the FCA in the U.S. (1997 – 2001)

	Benefit (millions)		Cost (millions)
Recoveries from Fraud	4,103 (3,490 net of payment to relators)	**Cost of Pursuing Legitimate Cases**	310
Estimated Potential Fraud Deterred	Hard to quantify	**Cost of False & Baseless Cases**	792
		Conflict with Voluntary Disclosure Program	Hard to quantify but expected to be less than the benefit of fraud deterrence effect
Total	4,103 (3,490 net of payment to relators)		1,102
Net Benefit			2,588

Note: the recoveries from fraud figure is the amount recovered between 1997 and 2001. This is to match the time period of the estimated costs

The recoveries from fraud figures are derived from U.S. Department of Justice's False Claims Act Statistics (2008). The cost figures are derived from work done by Carson et al. (2008).

In the U.S., the quantifiable financial benefit of the FCA exceeds its quantifiable costs. In addition, the author of this paper believes that the FCA's fraud deterrence benefit is likely to exceed the cost of potential conflicts between the FCA and voluntary compliance and disclosure programs.

The benefits and costs of FCA-like legislation in Canada are expected to be similar to that of the FCA in the U.S. but on a smaller scale. The following forecast assumes that the benefits and costs scale linearly with government spending on private contractors (Canada spent about $15

billion in 2007, U.S spent about $1 trillion in 1997-2001 (OMB Watch, 2009)). Based on this assumption, the financial benefits of FCA-like legislation are expected to exceed its costs.

Table 2 – Projected Yearly Cost & Benefit of FCA-like Legislation in Canada (2007)

	Benefit (millions)		Cost (millions)
Recoveries from Fraud	62[7] (52[8] net of payments to relators)	**Cost of Pursuing Legitimate Cases**	5[9]
Estimated Potential Fraud Deterred	Hard to quantify	**Cost of False & Baseless Cases**	12[10]
		Conflict with Voluntary Disclosure Program	Hard to quantify but expected to be less than the benefit of fraud deterrence effect
Total	62 (52 net of payments to relators)		17
Net Benefit			38

[7] 4.1 billion/1 trillion * 15 billion = 62 million
[8] 3.49 billion/1trillion * 15 billion = 52 million
[9] 310 million/1 trillion * 15 billion = 5 million
[10] 792 million/1 trillion * 15 billion = 12 million

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