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August 3, 2012

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Ave., NW
Washington, D.C. 20224

Re: IRS Interpretation of Planned and Initiated Limitation of IRC 7623

The National Whistleblower Center (NWC) is writing in response to the invitation from the Deputy Commissioner of the Internal Revenue Service (IRS), Steven Miller, at a recent meeting with whistleblower attorneys to provide comments on potential areas of review and regulation by the IRS and the Department of Treasury in regards to IRC 7623 – the whistleblower award statute.

A key part of the IRS whistleblower statute – Internal Revenue Code (IRC) 7623 – potentially limits the award provided to a whistleblower who has "planned and initiated" the action that led to the underpayment of tax for which the whistleblower seeks an award. It should be understood that the limitation is also a protection – seeking to send a clear signal to whistleblowers who were involved in an activity (but did not plan and initiate) that they will be entitled to an award if they come forward with information.

Unfortunately, the Internal Revenue Manual (IRM), as currently written, has defined "planned and initiated" in a manner that is at odds with the statute, undermines Congressional policy and actively discourages knowledgeable and informed whistleblowers from coming forward. Further, the IRM fails to take into consideration the history and context of the "planned and initiated" limitation– which is based on the 1988 amendments to the False Claims Act (FCA) – as well as the interpretation of "planned and initiated" in the FCA by the courts and the Department of Justice.

IRS and Treasury officials should recognize that correctly interpreting the "planned and initiated" language is a linchpin to the success of the whistleblower program and addressing significant tax evasion.

The IRS's annual report on the whistleblower program acknowledges in the executive summary that vital to the success of the program is encouraging insiders to come forward: "The primary purpose of the Act was to encourage people with knowledge of significant tax noncompliance to provide that information to the IRS . . . **Many of the individuals submitting this information claim to have inside knowledge of the transactions they are reporting, and often provide extensive documentation to support their claims.**" Internal Revenue Service, *Fiscal Year 2011 Report to Congress on the Use of Section 7623*, Jun. 20, 2012 (emphasis added).

The whistleblower program has been a success in assisting the IRS, as acknowledged by the Deputy Commissioner of the IRS Steven T. Miller in his June 20, 2012 memorandum on the program:

> [T]housands of whistleblowers have reported hundreds of millions of dollars in suspected tax compliance issues, resulting in a wide range of audits and investigations. Some of these audits and investigations have yielded significant results, demonstrating that whistleblower information can be an important tool in our compliance programs.

Unfortunately, the FY 2011 report on the whistleblower program highlights a drop in the number of whistleblower claims that are being filed. We appreciate that senior IRS officials have expressed concerns about the reduction in filings by whistleblowers. While there are a number of factors involved in whistleblowers being reluctant in coming forward, there is no question that the inappropriate and overly broad definition of "planned and initiated" is a significant factor – especially in discouraging key whistleblowers with inside knowledge from submitting information to the IRS.

We take in good faith the IRS's desire to have whistleblowers assist the IRS in addressing tax underpayments and evasion. To that end, it is vital that the implementation of the "planned and initiated" language provide for limitation on awards only to those whistleblowers who are the Principal Person, Chief Architect or Chief Wrongdoer – in keeping with the longstanding guidance by the Congress and the courts as well as the counsel provided by the leading authority in Congress on whistleblowers and successfully encouraging whistleblowers to come forward, Senator Grassley. For the IRS whistleblower program to thrive, a clear signal must be sent that the IRS welcomes and will award whistleblowers who come forward with valuable inside information. The IRS must recognize that whistleblowers with inside information who receive awards will often not be perfect.

The NWC encourages the IRS to remove and rewrite the IRM provisions regarding "planned and initiated" and to also ensure that any regulations on "planned and initiated" conform to Congressional intent as well as the courts' interpretation under the FCA. Such steps will benefit the vast majority of honest taxpayers and will help to ensure the success of the whistleblower program in assisting the IRS in its vital work.

A. The Law – IRS Whistleblower Law § 7623(b)(3) and FCA § 3730(d)(3)

The limitation of awards for tax whistleblowers that "planned and initiated" an action is found in the IRS whistleblower law § 7623(b)(3):

> **If the Whistleblower Office determines that the claim for an award under paragraph (1) or (2) is brought by an individual who planned and initiated the actions that led to the underpayment of tax or actions described in subsection (a)(2), then the Whistleblower Office may appropriately reduce such award.** If such individual is convicted of criminal conduct arising from the role described in the preceding sentence, the Whistleblower Office shall deny any award. IRC § 7623(b)(3) (emphasis added).

The language from § 7623(b)(3) is similar to the language in the FCA, which is widely recognized as the precursor and basis for the IRS whistleblower statute. "The taxpayers have reaped the success of the False Claim Act whistleblower rewards program. They'll benefit from the same concept applied to tax cheating." Press Release, Senator Grassley, author of FCA and the IRS whistleblower laws (Jan. 5, 2007) (praising the naming of Mr. Whitlock to be head of the new IRS Whistleblower Office). "The [IRS whistleblower] statute provides significant guidelines based on the success of the False Claims Act . . ."Letter from Senator Grassley to Treasury Secretary Henry Paulson (Jan. 5, 2007) (urging effective implementation of the IRS Whistleblower Law).

The FCA provision regarding "planned and initiated" is as follows:

> Whether or not the Government proceeds with the action, **if the court finds that the action was brought by a person who planned and initiated the violation of section 3729 upon which the action was brought, then the court may, to the extent the court considers appropriate, reduce the share of the proceeds of the action** which the person would otherwise receive under paragraph (1) or (2) of this subsection, taking into account the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation. If the person bringing the action is convicted of criminal conduct arising from his or her role in the violation of section 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action. Such dismissal shall not prejudice the right of the United States to continue the action, represented by the Department of Justice. 31 U.S.C. § 3730(d)(3) (emphasis added).

As mentioned earlier, the IRS whistleblower provision is based on the FCA. When the IRS Whistleblower law is using exact terms and phrases as the FCA – as is the case with "planned and initiated" then the term as understood and applied to the FCA should carry substantial weight.

It has been long-viewed as a canon of statutory interpretation that courts look to previously enacted statutes (especially statutes on the same subject – *in pari materia*) to assist in determining Congressional meaning and intent. *See Erlenbaugh v. U.S.*, 409 U.S. 239, 243-244 (1972) ("The rule of *in pari materia*. . . is a reflection of practical experience in the interpretation of statutes: a legislative body generally uses a particular word with a consistent meaning in a given context. . .a 'later act can . . . be regarded as a legislative interpretation of [an] earlier act . . . in the sense that it aids in ascertaining the meaning of the words as used in their contemporary setting,' and 'is therefore entitled to great weight in resolving any ambiguities and doubts.' The rule . . . necessarily assumes that **whenever Congress passes a new statute, it acts aware of all previous statutes on the same subject**. . .") (emphasis added) (internal citations omitted).

The Supreme Court in *Erlenbaugh* cites in support of this view *United States v. Freeman*, 44 U.S. 556, 564-565 (1845). *Freeman* is arguably the definitive statement by the Court on this issue and is worth reading the relevant section:

"The correct rule of interpretation is, that if divers statutes relate to the same thing, they ought all to be taken into consideration in construing any one of them, and it is an established rule of law that all acts in pari material are to be taken together, as if they were one law. If a thing contained in a subsequent statute be within the reason of a former statute, it shall be taken to be within the meaning of that statute. . ."

The term "planned and initiated" was contained in an amendment regarding limitations on payments of whistleblowers under the FCA and was authored by Senator Grassley. The term "planned and initiated" was similarly included as a provision regarding limitation on payments of whistleblowers under the IRS Whistleblower Act and was authored by Senator Grassley as well. As to *in pari materia*, the IRS Whistleblower law is a rib from the FCA; the two share a host of key provisions, in addition to the "planned and initiated" limitation, other common provisions include the right of a whistleblower to a mandatory award and having that award or denial subject to judicial review.[1] These facts (and others footnoted) are significant grounds for finding that the intent and meaning of "planned and initiated" contained in the FCA should serve as the key for guidance interpretation of the same phrase for the IRS whistleblower law.

Finally, Senator Grassley himself states:

"I ask that you give serious consideration to the points raised in their letter. As they note, there is along and established history regarding the meaning of "planned and initiated. The IRS should consider this history and practice at other federal agencies and not attempt to create its own policy that could conflict with this longstanding practice.

On a related matter, in IRM section 25.2.2.9.2.13.C, the IRS attempts to categorize a "whistleblower's role as a planner and initiator as significant, moderate, or minimal." As stated in the letter from the three organizations, limitations for planners and initiators was intended to apply to the ***chief architect*** or the ***chief wrongdoer***. I ask that you take into consideration the established law in this area with respect to FCA claims." Letter from Senator Grassley to the IRS Commissioner (Sept. 13, 2011) (citing favorably to an Aug. 10, 2011 letter by a number of whistleblower organizations, including NWC, that raises many of the concerns in this latter and cites to the traditional meaning of "planned and initiated") (emphasis in original).

More recently, Senator Grassley asked about regulations about planners and initiators – and stated: "As I have said before, there is no reason for the IRS to recreate the wheel in this

[1] Other examples of commonality between the two provisions are the allowance for payment schemes based on the level of information provided by the whistleblower; e.g. a range of 15% to 30% of payment to a whistleblower is authorized if action taken on the whistleblower's information; a broad definition of what will be considered "amounts" for determination of a whistleblower award ("alternate remedy" under the False Claims Act); the parallel treatment of less than 10% for a less substantial contribution under 26 U.S.C. § 7623(b)(2) and awards under 31 U.S.C. § 3730(d) for False Claims Act. In sum, the two statutes are a classic example *of in pari materia.*

area."[2] Letter from Senator Grassley to Treasury Secretary and IRS Commissioner (Apr. 30, 2012).

The standards of statutory construction and the author of the legislation both speak to the IRS looking to the FCA, the legislative intent of the FCA in adding the "planned and initiated" language, and the court cases interpreting "planned and initiated" under the FCA for the relevant guidance in constructing the meaning of "planned and initiated" for interpreting "planned and initiated" under §7623.

B. Legislative Intent of Planned and Initiated – The "Principal Architect" and "Principal Wrongdoer" Test

There is no discussion of "planned and initiated" in the legislative record of § 7623(b)(3). This is understandable given that the key Senator responsible for the legislation, Senator Grassley, would have viewed additional guidance as unnecessary given that the well-worn phrase had already benefitted from significant illumination by Congress when it was the focus of a special amendment to the FCA in 1988. Further, as shown above Senator Grassley fully intended that the "planned and initiated" provision of § 7623 would be read in keeping with the interpretation of the same language in the FCA. Fortunately, there is significant evidence of legislative intent of the term "planned and initiated" when it was added to the FCA in 1988 by Senator Grassley and other members of Congress. This legislative history is of great relevance in providing an understanding of "planned and initiated" when used in the IRS whistleblower law.

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[2] Senator Grassley is cited in this submission as a guide on "planned and initiated" to the IRS for both Congressional intent of the IRS whistleblower language and general policy. This is because Senator Grassley is not only the author of the provision – but also because of his widely recognized leadership in whistleblower issues for years by the entire federal government. Senator Grassley's thoughts and input of what can lead to success for the whistleblower program are invaluable and should serve as a shining light to the IRS and Treasury as it seeks to draft effective policy in this area.

It should be kept in mind that while not commonplace, the U.S. Supreme Court has cited and relied on statements made by legislators after a bill has been signed into law to guide them in determining legislative intent – especially when those statements come from lawmakers who are key figures in the drafting of the provision as is the case with Senator Grassley: *See Pacific Gas and Electric Company v. State Energy Resources Conservation & Development Commission*, 461, U.S. 190, 220 n.23 (1983) ("While expressions of a subsequent Congress generally are not thought particularly useful in ascertaining the intent of an earlier Congress, Senator Hickenlooper, the sponsor of the 1965 amendment, was an important figure in the drafting of the 1954 Act.");*North Haven Board of Education v. Bell*, 456 U.S. 512, 530-531 (1982) ("The post enactment history of Title IX provides additional evidence of the intended scope of the Title and confirms Congress' desire to ban employment discrimination in federally financed education programs. Following the passage of Title IX, Senator Bayh published in the Congressional Record a summary of the final version of the bill. That description expressly distinguishes Title VI of the Civil Rights Act of 1964 with respect to employment practices . . ."). The Court further went on to cite statements made by the Senator Bayh two years after passage.

The legislative intent demonstrates that the drafters of the "planned and initiated" provision under the False Claims Act desired that the amendment would "apply *narrowly to principal wrongdoers*." 134 Cong. Rec. S16697 (daily ed. Oct. 18. 1988) (statement of Sen. Grassley); *see also* 134 Cong. Rec. H10637 (daily ed. Oct. 20, 1988) (statement of Rep. Berman) ("amendment we are voting on today will allay any criticism that the False Claims Act will encourage *principal wrongdoers* to file false claims actions solely motivated by the desire to profit from their own previous wrongdoing."). The amendment was designed to prevent those who are the "main force behind a false claims scheme" from recovering. 134 Cong. Rec. S16697 (daily ed. Oct. 18. 1988) (statement of Sen. DeConcini).

In fact, Senator Grassley said this of his 1988 proposed amendment: "[m]y amendment simply clarifies that in an extreme case where the qui tam plaintiff was a *principal architect* of a scheme to defraud the Government, that plaintiff would not be entitled to any minimum guaranteed share of the proceeds of the action." 134 Cong. Rec. S16697 (daily ed. Oct. 18. 1988) (statement of Sen. Grassley).

In addition, the drafters of the amendment recognized that often only the people who participated to an extent in the fraud would have knowledge of its actions. 134 Cong. Rec. S16697 (daily ed. Oct. 18. 1988) (statement of Sen. Grassley). Furthermore, the original FCA, as a whole, was premised on the notion that it requires "a rogue to catch a rogue." *See* Cong. Globe, 37th Cong., 3d Sess. 955-56 (1863) (remarks by Senator Howard explaining that the law was meant to provide "a strong temptation to betray his conspirator, and bring him to justice.").

In applying the "planned and initiated" limitation, the courts have understandably looked to the above cited Congressional statements of intent to guide them. *See Barajas v. Northrop Corp.*, U.S. Dist. LEXIS 22817 *15-17 (C.D. Cal. 1992) (citing statements by Congressman Berman and Congressman Grassley that the "planned and initiated" limitation was directed at the principal wrongdoer or the principal architect). The U.S. Government has also cited the Congressional history for determining the intent of "planned and initiated." *See id.* at *37-38 (Department of Justice citing the whistleblower as "the principal wrongdoer").

The entire relevant statement by the *Barajas* Court is worth review:

> "The legislative history of the 1988 FCA amendment, which added section 3739(d)(3), suggests that "**in an extreme case** where the qui tam plaintiff is a **principal architect** of a scheme to defraud the government," that plaintiff may not be entitled to any share of the proceeds of the action." *Id.* at *36-37 (emphasis added).

The *Barajas* court goes on to embrace the Principal Architect test: "The Court must finally consider the extent to which Barajas can be considered a *principal architect* of the testing fraud . . ." *Id.* at *39 (emphasis in original).

The Congress made clear its legislative intent and the courts have followed – "planned and initiated" is a limitation that is intended to be rarely invoked in extreme cases and only for the "Principal Architect" or "Principal Wrongdoer."

C. Dictionary Definition – Plain Meaning of "Planned and Initiated"

The words "plan" and "initiate" have plain meanings in the English language. "Plan" means "a delineation; a design; a draft, form or representation...a scheme; a sketch. Also, a method of design or action, procedure, or arrangement for the accomplishment of a particular act or object." Black's Law Dictionary (5th ed. 1979). "Initiate" denotes to "commence; start; originate; introduce; inchoate." *Id.*

Why does a plain meaning of the words "plan" and "initiate" matter? In *Schindler Elevator*, a FCA case, the Court referred to several Dictionary definitions of the word "report" to ascertain its meaning. *Schindler Elevator Corp. v. U.S. ex rel. Kirk*, No. 10-188, slip. op. (U.S. May 16, 2011) ("Statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose').

A similar review of the dictionary definition of "planned" and "initiated" combined sits comfortably with what is the express Congressional intent of the phrase "planned and initiated" as being limited to the "Principal Wrongdoer" or "Principal Architect."

D. "Principal Architect" or "Principal Wrongdoer" Test for "Planned and Initiated"

As seen above, a fair reading of the Congressional intent, adopted by the courts (as seen further below) and the plain language of the words leads to a conclusion that the "planned and initiated" exception is to apply to an extremely narrow group of individuals – the "Principal Architects," or "Principal Wrongdoers" – i.e. the individuals who *both* originated, introduced or started the scheme *and also* designed, drafted and arranged the scheme. Underscoring the narrowness of the test is that it is a requirement of planned *and* initiated not "or" – the individual must do both – plan *and* initiate to be subject to the limitation. It is commonly recognized in statutory construction that the use of the word "and" means that all the listed requirements must be satisfied. *See* Statutory Interpretation: General Principles and Recent Trends, March 30, 2006, Congressional Research Service Report 8 (2006). Furthermore, it should be noted that courts have established that, when interpreting whistleblower law language, they should interpret in a way that is most favorable to the whistleblower.[3]

To give an example, it is the Madoffs of the world – the "Principal Wrongdoer" or "Principal Architect" who Congress was seeking to ensure did not get an award when it added the "planned and initiated" test. Congress recognized that the vast majority of insiders – while not perfect, and not with clean hands – were also not the Principal Architect or Wrongdoer and

[3] *See Haley v. Retsinas*, 138 F.3d 1245, 1250 (8th Cir. 1997) ("when the meaning of the statute is unclear from its text, courts tend to construe it broadly, in favor of protecting the whistleblower. This is often the best way to avoid a nonsensical result and 'to effectuate the underlying purposes of the law.'" S.A., 129 F.3d at 998.); *Hill v. Mr. Money Fin. Co. & First Citizens Banc Corp.*, 309 Fed. Appx. 950, 961 (6th Cir. 2009) ("when statutory language of whistleblower provisions is ambiguous and/or broad, courts do tend to construe the language "in favor of protecting the whistleblower.").

were exactly the individuals that were most likely to know about the fraud and who Congress wanted to reward and encourage to come forward when it created the IRS whistleblower law.

In line with the "Principal Architect" or "Principal Wrongdoer" test of the "planned and initiated" limitation being a high bar, the Department of Justice has recognized that there are only a rare number of cases where the "planned and initiated" limitation should even be considered. *See Barajas* at *17 (Government claims that it intends to use *section 3730(d)* the planned and initiated limitation sparingly and that the Government has only had occasion to invoke the provision once before).

E. Cases on Planned and Initiated Test

The courts that have applied the FCA "planned and initiated" exception have been in line with both the Congressional intent and the plain language of the statute as summarized above – finding a very narrow reading of when the planned and initiated limitation applies and applying it in practice only to the "Principal Wrongdoer" or "Principal Architect."

1. *Marchese v. Cell Therapeutics, Inc.*

In *Marchese*, the court considered whether the whistleblower, Mr. Marchese, was subject to the planned and initiated limitation. *Marchese v. Cell Therapeutics, Inc.*, 2007 WL 4410255 (W.D. Wash. 2007).Mr. Marchese worked as a sales representative at a drug company, Cell Therapeutics, Inc. (CTI) that manufactured a product called Trisenox. For a drug being used for an "off-label" purpose (not what FDA approved the drug to be used for) to be eligible for Medicare requires that it be cited in a specific drug compendium (there were two such compendia at the time).

Mr. Marchese was the lead person at CTI for seeking to have Trisenox's off-label products listed in a compendium and presumably reimbursable by Medicare. Mr. Marchese prepared an analysis on how CTI could get Trisenox's off-label indications listed in the compendia so those indications could be reimbursable by Medicare. *Id.* at *3.

It was Mr. Marchese's idea to seek publication of Trisenox's off-label indications in the compendia based on Trisenox's orphan drug designations. Mr. Marchese benefitted from analysis by Documedics – an outside consultant – that stated that if the off-label purposes received orphan drug status that would qualify for listing in the compendia and thus subject to Medicare reimbursement. Documedics was wrong – while orphan drug status did provide listing in the Compendia – only in Volume III and thus not subject to Medicare reimbursement (Volume I is where the drug usage needed to be listed for purposes of Medicare reimbursement). Mr. Marchese's superiors at CTI also advised Mr. Marchese, erroneously, that an off-label orphan drug designation would allow for Medicare reimbursement. *Id.* at *3-4.

Trisenox is listed in Volume III and in that compendium it is noted that they are not reimbursed by Medicare (Mr. Marchese was unaware of this notation). Mr. Marchese and an employee of Documedics wrote the early drafts of a letter to physicians stating that Trisenox off-

label was now listed in the compendia and available for Medicare. Mr. Marchese's supervisors and consultants at Documedics reviewed the letter for accuracy.

In response to the letter drafted by Mr. Marchese, physicians began proscribing the drug and (improperly) asking for Medicare reimbursement. Over time, beginning in December 2001, Mr. Marchese became disillusioned by the actions of CTI in general and in particular about the off-label promotion of Trisenox when he learned that the drug was causing patient harm and that the clinical trials had been discontinued and began to raise concerns internally.

During this time Mr. Marchese learned that CTI was violating federal regulations in its promotion of Trisenox for off-label uses. Mr. Marchese did not immediately report these violations. Instead, Mr. Marchese sought approval from the company, in the form of a promotion, for his efforts in having Trisenox published in the compendium. Mr. Marchese was fired from CTI in September 2002. In November/December 2002 Mr. Marchese contacted the Office of Inspector General about his concerns about the off-label use. The Office did not respond. Mr. Marchese contacted officials at the FDA in 2003 also about the health risks as well as the FBI in 2004 about CTI matters. *Id.* at *6-8.

In sum the Court found that: Mr. Marchese was the responsible official; Mr. Marchese prepared the (false) analysis for getting the off-label drug listed in the compendia so that it could be eligible for Medicare; Mr. Marchese first had the idea to get the off-label usage listed in the compendia so that it could be (falsely) eligible for Medicare; Mr. Marchese co-drafted the letter to the physicians informing them (falsely) that the off-label drug was listed and now available for Medicare reimbursement; and, Mr. Marchese when he became aware that CTI was violating federal regulations did not report the violations. Despite all these facts, the Court *still* found that Mr. Marchese was *not* the planner and initiator. *Id.* at *8-9.

> Finally, the Court does not find that Mr. Marchese was the planner and initiator of a scheme to deceive physicians into believing Trisenox was a medically accepted drug for its off-label uses and to deceive Medicare into reimbursing those off-label prescriptions. The Court concludes that Mr. Marchese relied on consultants at Documedics and his supervisors who advised that prescription for off-label uses was eligible for Medicare reimbursement if that indication has been granted orphan drug status. *Id.* at *8.

2. *U.S., ex rel. Taxpayers Against Fraud v. General Electric Co.*,

Given the key role played by whistleblowers who are insiders in discovering a fraud, it is not surprising that the cases in the False Claims Act are replete with examples of individuals who are not perfect, engage in certain inappropriate actions and may even be in management – yet still receiving significant awards. These individuals are found not to have met the planned and initiated limitation (in fact, the issue of "planned and initiated" is rarely even addressed because the bar is so high). A good example of these cases is found in *General Electric* involving a middle manager. *United States ex rel. Taxpayers Against Fraud v. GE*, 41 F.3d 1032 (6th Cir. 1994).

In brief, *General Electric* dealt with an effort by Israeli military officials and others to skim millions of dollars from U.S. Government military-aid funds. The whistleblower, Mr. Walsh, was an employee of GE at the time. GE accused the whistleblower of planning and initiating the fraud, as the whistleblower held "the principle responsibility for administrating" the contracts in question. GE further claimed the whistleblower was "directing the creation of false-claim documentation and devising the paper trail by which the transactions were structured," and "preparing counterfeit notices and work-completion certificates." *Id.* at 1039-40.

The whistleblower's response was that the fraud had been planned and initiated prior to his arrival, and that when he learned of the scheme after more than two year on the job, the whistleblower began taking steps to uncover and stop it. *Id.* at 1037.

The Appellate Court in *General Electric* cites the record of the district noting: "At one point during the final day of the Attorneys' Fees Litigation, the district court said that "[t]here is not one iota of evidence before me that Mr. Walsh participated in the fraud. Not one." However, the judge's remarks were not confirmed as part of the court's formal findings."

The district court held a hearing *in camera* because an investigation was ongoing and awarded the whistleblower a 22.5% share of the civil recover (where 25% was the maximum possible recovery). *Id.* at 1040.

One minor but perhaps relevant note, the District Court in its discussion of the case chastised the Department of Justice for attacking the whistleblower for not coming forward sooner.

The most that the Department of Justice can assert is that he "should have" revealed this information earlier. It is very easy to fall into the trap of "should have." Lawyers particularly prone to use that argument when after the benefit of excellent hindsight a different method of procedure can be devised. *United States v. Gen. Elec.*, 808 F. Supp. 580, 583 (S.D. Ohio 1992).

3. *Barajas v. Northrop Corp.*

While the *Marchese* and *General Electric* courts highlight how high a bar it is to make a finding of planned and initiated, it is perhaps even more illuminating to look at the extremely rare cases where the court has found the planned and initiated limitation has been met.

Barajas dealt squarely with the question of the "planned and initiated" test. As noted earlier, the Court cited to the statements by Congressman Berman and Senator Grassley to help explain the purpose of the provision and citing with emphasis the "Principal Architect" requirement stated by Senator Grassley. *Barajas*, U.S. Dist. LEXIS 22817 at *37. The government also agreed that the "Principal Wrongdoer" test was correct – stating that the plan and initiate test was appropriate in the case because Barajas, the whistleblower, was the *principal wrongdoer* in the view of the government. *Id.* at *36.

Mr. Barajas began working at Northrop in 1981 and continued until 1987. Barajas' job was one of two people in Northrop's testing division that was principally responsible for testing the Flight Data Transmitters (FDTs) to be used on a cruise missile. Northrop was required under

the contract to subject these FDTs to three performance tests before sending them to Boeing for installation: 1) a test of the circuit boards; 2) a product reliability verification test (PRVT); and, 3) a Final Acceptance Test (the "Acceptance Test"). *Id.* at *17-19.

Mr. Barajas began performing the PRVT and Acceptance Tests in early 1982 and continued to the principal test until his departure from Northrop in 1987. Barajas admitted that beginning in 1983 he began to systematically fake many of the FDT test results by recording made up numbers on the test charts rather than actually performing the required series of tests. Although Barajas was directed to falsify some of the PRVT test results by his supervisors, he admitted that he falsified many of the Acceptance Tests on his own initiative due to the time pressure to complete his work and his belief that the equipment provided by Northrop was faulty. *Id.* at *19.

Mr. Barajas testified to a number of falsified test results. Mr. Barajas admitted that when Boeing's inspector came, Mr. Barajas would open the test machines and alter them so that they would artificially indicate that the machines met the proper specifications. *Id.* at *20.

Over time Mr. Barajas' test falsifications increased. For example, for one subset of tests ("Power Input") he had earlier in 1983 falsified 50% of the tests and later during 1984-86 he falsified 99 percent of the tests. *Id.*

Although Barajas' supervisors actively participated in and directed him to falsify the data in the PRVT tests, Barajas has admitted that no one ever directed him to falsify the results of the Acceptance Tests he performed (representing 2/3rd of the value of the $8 million settlement in the case). Mr. Barajas admitted that in many instances that he never told his supervisors that he was falsifying the acceptance tests. Only Mr. Barajas knew of certain testing violations. *Id.* at *21.

The Court found that the evidence is undisputed that Mr. Barajas began falsifying the Acceptance tests in 1983 on his own initiative due to the time pressure and his belief that the FDTs would fail the Acceptance Tests anyway. The Court found that Mr. Barajas admitted that he took it upon himself to falsify the tests and makeup phony results and *acknowledged that he was never directed to do so.*

Moreover, Mr. Barajas never directly told any of his supervisors that he was falsifying the Acceptance tests. The Court found that Mr. Barajas engaged in not a one-time lapse, but an ongoing program of lying and falsification which Barajas initiated on his own and kept secret even from his own supervisors.

As mentioned in Section B discussion above, the Court enunciated the "Principal Architect" test from the legislative history and proceeded to apply the "Principal Architect" test separately to the two tests that were falsified: the PRVT and the Final Acceptance tests. *Id.* at *37,39.

The Court found that Mr. Barajas did **not** "plan or initiate" the fraud of the PRVT tests. The PRVT tests were ones that Mr. Barajas falsified – but at the direction of his supervisor. The

Court awarded Mr. Barajas a one-third share of the $1.44 million recover attributed to the PRVT test – $480,000 **without any reduction**. *Id.* at *39-40.

The Court found that Mr. Barajas was the principal architect of the falsification of the Final Acceptance tests. *Id.* at * 40.

These were the tests that were falsified at Mr. Barajas' own initiative and without informing his supervisors. Nevertheless despite finding that the planned and initiated limitation was met, the Court in *Barajas* still awarded the whistleblower proceeds from the recovery of the false Final Acceptance tests as well. Overall, Mr. Barajas received $864,000 or 10.8 percent of the settlement. *Id.* at *41-42.

The Court cited in making its determination to award Mr. Barajas the fact that Northrop created an environment which encouraged and at least tacitly condoned such conduct. The Court also found that the information provided by Mr. Barajas was of great importance to the government since it helped the United States uncover testing violations taking place in an important weapons system. The Court also stated its belief that Mr. Barajas was the first person to reveal evidence to the government of Northrop's testing fraud. *Id.* at *30-31.

4. *Stearns v. Lane*

In a recent case, *Stearns*, dealing with fraud in Housing Assistance Payments (HAP), the Court found the whistleblower had planned and initiated the action and the whistleblower was denied any award. *United States ex rel. Stearns v. Lane*, No. 2:08–CV–175, 2010 WL 3702538 at *6 (D. Vt. 2010).This case is particularly illuminating because it provides the rare example of someone actually found to have planned and initiated by the Court.

The basic facts are as follows: Ms. Stearns, the whistleblower, received a Section 8 voucher for housing. Ms. Stearns asked to approve Mr. Lane's premises for a Section 8 subsidy. On her application, Ms. Stearns falsely represented that her husband would not be residing with her, in order to avoid having his disability payment included in the calculation of her portion of the rent. Ms. Stearns and Mr. Lane entered into a lease for $1,100 and $50 for water. There were two copies of the lease with Ms. Stearns – one which stated that Ms. Stearns had paid the security deposit, which was required in order to use the Section 8 housing and a second that stated that only $154.00 had been paid, as was actually the case. *Id.* at *1-2.

Given the requirements of the HAP contract, Mr. Lane wrote a lease for $1,081.00. However, Mr. Lane informed Ms. Stearns that he would need to continue to receive the amount of the original lease ($1,000 plus $50 for water). Ms. Stearns did not tell the government that she was paying Mr. Lane any additional money during this year, nor did she inform the government that her husband was residing with her. *Id.*

Ms. Stearns' husband (who had been living with her the entire time) had gotten violent and Mr. Lane stated that Ms. Stearns needed to tell the Government about her husband's presence and get him on the lease. After several months, Ms. Stearns informed the government that her husband was residing with her, and her contribution to the rent rose by over $400.00 per

month. In response to these developments, Ms. Stearns reported to the government her side payments to Mr. Lane. *Id.* at *2.

Not surprisingly, given these facts – that the entire proposal from stem to stern was Ms. Stearns'– the Court found that Ms. Stearns met the planned and initiated limitation. *Id.* at *5. Ms. Stearns planned the fraud and she initiated the fraud.

5. Conclusions – Courts Applying "Principal Architect/Wrongdoer" Test to "Planned and Initiated" Limitation

As seen in the cases discussed, the courts either openly state that in deciding on the "planned and initiated" limitation that they are applying the "Principal Architect" or "Principal Wrongdoer" or effectively do so in practice.

The bar for finding "planned and initiated" has been set very high by the courts. Even in findings that an individual meets the "planned and initiated" limitation, the court still will look at other factors – such as knowledge, concealment, direction by management – to find that the whistleblower does not meet the "Principal Architect" or "Principal Wrongdoer" test.

In brief, no "plan and initiated" limitation in the case of *Marchese* – where the individual was the initiator of the idea, planned the idea (but under a misunderstanding of its false premise as well as reliance on superiors – mitigating factors in favor of the whistleblower). *General Electric* – no planned and initiated limitation despite individual being middle manager – scheme was ongoing prior to his arrival. *Barajas* – the Court splits the baby finding the "planned and initiated" limitation was met when tests were falsified at the whistleblowers initiative and he actively covered it up from his supervisors – that he was the "Principal Architect"; and, alternatively, that the whistleblower did NOT meet the "planned and initiated" limitation and the "Principal Architect" test when he falsified tests done at the direction of his supervisors. Finally, in *Stearns* the Court found that the individual was entitled to no award when she put forth and implemented her proposal of falsifying her application – and there were no extenuating circumstances.

H. Summation of Law, Precedent, Congressional Intent and Policy of Planned and Initiated

The law, precedent and Congressional intent are all of a piece and arrive at the same place as to the "planned and initiated" limitation. The plain reading of the statute requires for both planning and initiating an action. This fits easily with Congress' intent that planned and initiated should apply only to the "chief wrongdoer" or "chief architect" – that is naturally who will be planning and initiating.

The courts have similarly viewed planned and initiated as a high threshold (as has the Department of Justice) and have consistently found that an individual who is not the chief architect or chief wrongdoer – i.e. who did not plan and initiate – is not subject to the planned and initiated limitation – even in cases where the whistleblower has been closely involved with the actions and did not have clean hands. Conversely, in the rare instance where planned and

initiated has been invoked it is in a case where the person planned and initiated – they were the chief architect or chief wrongdoer.

Finally, the definition of planned and initiated as the chief wrongdoer or chief architect has ensured that Congressional policy is not frustrated. A definition of planned and initiated that was sweeping – encompassing anyone who assisted, furthered, advised, etc. – would effectively shut off for the government the valuable information it receives from inside and knowledgeable whistleblowers. To limit awards to whistleblowers to only those individuals who help the girl scouts prior to work and go to choir practice right after work is to ensure the failure of the whistleblower program – with only those engaged in tax evasion benefitting. Unfortunately, as discussed further below, the IRM definition of planned and initiated is not helpful to the success of the whistleblower program. The IRM fails to follow the plain reading of the law, the caselaw, Congressional intent and in doing so frustrates the public policy goal of encouraging whistleblowers with inside knowledge to come forward.

I. Internal Revenue Manual – Determination and Factors for Planning and Initiating

The IRM lists at 25.2.2.9.2.13.C and D that in making a 7623(b)(3) determination, the whistleblower office will:

> "C. [E]valuate the whistleblower's role in planning and initiating the actions that led to the underpayment and, based on this evaluation, categorize the whistleblower's role as a planner and initiator as significant, moderate, or minimal. The Whistleblower's Office evaluation will be informed by, but not restricted to, its consideration of the factors described below.
>
> D. The whistleblower Office will reduce the awards of (1) significant planners and initiators by 66% to 100%, (2) moderate planners and initiators by 33% to 66%, and (3) minimal planners and initiators by 0 to 33%. . ."

The IRS in IRM25.2.2.9.14lists the following five factors to be used in the Whistleblower Office's determination of whether the whistleblower planned and initiated the underpayment of tax:

> "Planning and Initiating Factors (applicable to section 7623(b) (3) determinations):
>
> A. Was the whistleblower the sole decision maker, one of several contributing planners and initiators, or an advisor to a decision maker?
> B. The nature of the whistleblower's planning and initiating activities. What did the whistleblower do – was it reasonably legitimate tax planning or objectively unreasonable, were steps taken to hide the actions at the planning stage, was there any identifiable misconduct (legal, ethical, etc.) that was either not criminally prosecuted, for whatever reason, or did not result in a criminal conviction (which results in a zero award)?
> C. The extent to which the whistleblower knew or should have known that tax noncompliance was likely to result from the course of conduct.