Flipping Markets to Virtue with Qui Tam and Restorative Justice

John Braithwaite

Abstract

Contemporary developed economies are characterised by a regulatory capitalism in which both markets and regulation get stronger. This nurtures markets in gaming regulation. Yet it also engenders markets in compliance services that can be virtuous and more dominant (more demanded) than markets in vice. As a result of that dominance, firms and individuals often comply at levels that seem economically irrational. To hold corporations to compliance through markets in virtue requires regulation with toughened enforcement capabilities for drawing out insider information about looming problems. Qui tam is suggested as one option. Also required are improved regulatory technologies that are deliberative and forgiving when firms defect from markets in vice to markets in virtue. Restorative justice is commended for that purpose.

Keywords: Tax enforcement, False Claims Act, restorative justice, regulatory capitalism

Research Highlights

• Regulation can learn to be more forgiving and preventative than contemporary practice, but also tougher.

1 John.Braithwaite@anu.edu.au: Regulatory Institutions Network, College of Asia and the Pacific, Australian National University, Canberra 0200.
• Qui tam can make enforcement more punitively formidable; restorative justice can make it more forgiving.

• Enforcement is not crafted to prevent crises such as runs on banks, stockmarket crashes, epidemics of mortgage fraud or fiscal collapse caused by tax shelters. Punishment is reactive after things go wrong.

• Partial privatisation of prevention/enforcement grounded in diagnosis of markets in vice and markets in virtue is a possible paradigm shift.

The plan of this essay is first to use tax compliance to consider the heightened tug of war between markets in virtue and markets in vice under conditions of regulatory capitalism. Then we consider qui tam as a promising tool for pushing the worst players of the market in vice to become the best players of the market in virtue. Then we consider how restorative justice might flip economies away from catastrophe and finally how qui tam might enable rather than disable restorative justice.

Regulating Tax Avoidance and Corporate Crime with Markets in Virtue

Tax cheating is economically rational behaviour. For most of the common forms of tax non-compliance, odds of detection are way below fifty per cent, while the expected punishment following detection is less than double the tax avoided. Yet the evidence from Australia and other developed economies is that most taxpayers comply with most tax laws most of the time (Braithwaite 2003a). Why are they so
irrational? One reason is that the epistemic community of professional tax advisers is more a market in virtue than a market in vice.

In *Markets in Vice, Markets in Virtue*, Braithwaite (2005) argued that the market in virtue is mainly demand-driven in Australia. Yuka Sakurai and Valerie Braithwaite’s (2003) data show that individual Australian taxpayers overwhelmingly prefer an ‘honest, low fuss’ tax adviser over a gameplayer who aggressively pursues loopholes. That is the kind of tax adviser they mostly want and that is what they mostly get.

When someone tut-tuts at a taxpayer, it is rarely a tax official. Usually it is a tax adviser who the taxpayer employed to do so. This is to say, when our adviser frowns, most of us respond with ‘oh dear, then we’d better not do that’. This reality that demand in the tax advice market is predominantly for tax compliance virtue is a great resource for tax authorities. If the authority is concerned that tax morality is becoming loose on employee work expenses, a good way to tighten it can be to get the message out to the epistemic community of tax advisors that the authority has this concern and is therefore planning to target the issue. Then tax advisers will do a lot of tapping people on the shoulder to check the legitimacy of their work expenses. A tap on the shoulder is all most taxpayers need to improve their compliance. For those who do not retain a tax advisor, they may still be tapped by family members or workmates who do. When a tax authority announces an intent to attack a particular corporate tax shelter after it becomes widely abused, even if tax advisers who put clients into that shelter choose not to upset their client with this bad news, other accounting advisers will read about the announcement in the financial and accounting press, and can do the work of putting senior management on notice that they have a problem. In other
words, the market in virtue is mostly redundant enough to fill the gaps that the market in vice can create.

While our empirical research at the Centre for Tax System Integrity concluded that the market in virtue is the dominant advice market in Australia, there is also a vibrant market in vice (Braithwaite 2003b, 2005). It has a cyclical quality. In times of crisis in tax system integrity it can expand very quickly. The art of tax administration is keeping the lid on these cycles. Empirically, we found that markets in vice are predominantly supply driven, then herd driven. The market niche for truly aggressive tax advice is a precarious one. In normal times, an adviser who puts an aggressive new shelter into the market comes up against the wall of conservatism generated by the market in virtue. Yet enticing just a few clients to use the shelter can get the aggressive advisor on a roll quickly if they have promotional flair. Chances are those few clients will get away with it if the shelter is half-credible and supported by letters of comfort from respected tax lawyers. When additional clients see the combined reality of the letters of comfort and the fact that previous clients have made a killing without the tax authority laying a hand on them, momentum in shelter sign-ups grows. Then it is possible for the market in vice to ‘go for broke’. The (false) marketing pitch can in effect become ‘everyone is getting away with this except patsies like you’.

Even when a stampede into shelters occurs, most taxpayers cling to the market in virtuous advice and most advisors tut-tut when questioned about joining the stampede. Doyens of the dominant market then scream to the tax authority and to their political masters because they are losing business to the market in vice. Then the tax authority garners the extra resources and the political will to crack down on the shelters. This takes long enough to mobilise for the market in vice to accumulate
stupendous wealth before shelters are shut down. At the end of the crackdown, shelter promoters are discredited, shunned by taxpayers who stampede back into the market in virtuous advice. Even so, participating in the cyclical niche market in vice can have been a good business choice for the shelter promoter. Some of their clients may lose their fortunes after the shelter bubble bursts. The promoters, so long as they stay out of jail, which is usually not difficult, just lose their future income stream. Their business model is to make their fortune while the bubble is expanding, then retire or move onto something else when it bursts.

There is a more general problem of the risks markets in vice pose to contemporary capitalism. Rogue traders in derivatives and other products can aggressively trade other peoples’ money in pursuit of bonuses that will be paid for large gains. When large losses occur, it is their clients or their shareholders who suffer. While the traders are discredited as traders, they have siphoned large amounts from their firms through their bonus accounts while the bubble rose. The bonuses might stop when it bursts, but if they have been aggressive enough on the upswing, their nest egg is so huge that they are well set up to move onto a different kind of business.

In this paper, I seek to draw some lessons from the mixed empirical experience of success and failure of tax administrations in flipping markets in vice to markets in virtue. I construe them as lessons of more general relevance to a contemporary capitalism in which:
(a) many different kinds of markets in vice cyclically rise and fall (in insider trading, monopolisation, fraud against the government, securities fraud, environmental crime, bribery);

(b) there is a demand-side and a supply-side to understanding those undulations and,

(c) the market in vice works by siphoning a share of the benefits of cheating on the upswing, setting up the mark to shoulder the costs of the downswing.

There is some generality to this phenomenon because part of the nature of contemporary capitalism is that it has freer markets and more rules that can be gamed (Vogel 1996) – it is a world of ‘regulatory capitalism’ (Levi-Faur 2005, 2006; Levi-Faur, Jordana and Giladi 2006). Competition policy has delivered one form of rules designed to invigorate markets, including rules against price fixing and monopoly. Braithwaite (2005, 2008) has argued that competition policy has had a degree of international success in enlivening competition. Not all the effects of more vigorous competition have been good, however. Stronger markets have delivered more efficient production of many things, including many good things and many bad things for people (such as gambling services, internet pornography and marketing fatty and sweet foods). One of those bad things that are more efficiently marketed today is tax avoidance and evasion services. Old professional boundaries among law firms, accounting firms and investment advisors have been breached as all these kinds of commercial actors have found that there is a lucrative market in the vice of tax cheating. So they encroach on one another’s traditional professional arenas in aggressively pursuing it.
Different people will have different views on what is good and bad, but the analytic point is that stronger markets will increase the efficiency of the production of bads as well as goods (however defined). Put another way, this essay is not interested in joining debates over what is good and what is bad, what is fraud and what is legal, what is black, white and grey. It is interested in the idea that whatever one’s conception of vice and virtue, there will be markets that produce the vice and markets that produce the virtue. At least this is true under conditions of regulatory capitalism where both goods and bads are produced with more competitive efficiency and in circumstances where more regulatory judgements are being made about what is good and what is bad. Because all of us have some conception of what should be thought of as vices, which includes fraud for most of us, we become concerned when markets become more vibrant in the production of those vices.

So far we have been considering the supply side story of the more efficient production of bads in a competitive economy. In *Markets in Vice, Markets in Virtue* we saw that there is an important demand side as well. Managers come under competitive pressure when their company is paying a legally appropriate amount of tax to apply “aggressive management techniques” to that liability (Kleinbard 1999). The market can demand managers who reject the view that paying tax is normative; it rewards managers who construe a tax liability as a problem that aggressive management can eliminate. Hence, a paradox of a more effectively liberal economy is that it forces us to make more judgements about vices we wish the state to regulate. Because a perfectly competitive market economy more efficiently produces more vice, indeed innovation into vices yet to be invented, it creates a greater demand from citizens for state regulation. This is a core dynamic of why we have entered the phase of
regulatory capitalism, where competitive markets do more of society’s rowing, but states do more steering. And so do private regulators such as ratings agencies and professions do more steering.

Flipping markets in vice to markets in virtue

Braithwaite (2005) discussed a variety of strategies for flipping markets in vice back to the dominant market in tax virtue. These included promoter penalties, targeting the clients of A lists of aggressive advisers, more sophisticated shelter disclosure regimes and corporate certification of continuous improvement in tax integrity. That work argues that a web of mutually reinforcing strategies are needed to hold most taxpayers into a dominant market in virtue. In this paper we will develop more fully just one of the neglected strategies on that list – restorative justice. And we develop one not developed on the 2005 list – qui tam suits. By the lights of this policy analysis, the important point about ‘What works?’ is suites of strategies integrated within a regulatory architecture that allows them to be mutually reinforcing most of the time. It is not about the overwhelming importance of any one or two strategies. The two strategies selected in this paper are selected only because of a belief that the contribution they can make has been neglected in fraud scholarship.

*Qui tam*

Corporate crime enforcement has a low success rate because of its poor record of getting insider testimony from large corporations that are breaking the law (Bucy 2002a, 2002b). The information asymmetry problem in corporate crime enforcement is profound. Insiders understand that if they stick together, investigations will blow
over without anyone going to jail, given the difficulty of proving complex commercial offences. They also understand that if on the other hand, they start talking to prosecutors, they often are subjected to smear campaigns by the firm that can run to accusing them of the very crimes on which they blow the whistle. It follows that one of the most strategic ways to undermine markets in vice is to improve its performance at getting inside information into the hands of law enforcers. That is the challenge that *qui tam* has begun to meet.

*Qui tam* is a shortened form of *Qui tam pro domino rege, quam pro se ipso in hoc parte sequitur*, which means in Latin ‘He who sues as much for the King as for himself’. *Qui tam* had a long history in British and US law characterised by much abuse until put on a more principled footing with 1986 amendments to the False Claims Act in the US. These allowed whistleblowers in cases of fraud against the government to take their evidence of fraud to the Justice Department. If Justice found their evidence new and meritorious, it could take over the whistleblower’s False Claims suit. When successful, a hefty percentage of the recoveries from the lawbreaker as a result of the suit are paid to the whistleblower. The False Claims Act has been extremely successful in drawing out whistleblowers with evidence that has led to massive penalties, particularly against pharmaceutical companies (Phillips 2009) and for fraud against government health programs more broadly. This has been a remarkable enforcement turn around, with most Big Pharma firms in recent years suffering penalties of hundreds of millions of dollars from False Claims Act suits that often led on to criminal prosecutions, and in some cases penalties of one or two billion dollars. The other area where the False Claims Act has had a transformative enforcement impact is defence contracting fraud. The limitation of the False Claims
Act is that most fraud and most corporate crime is not committed against the government. In addition, there are important types of fraud against government that are not caught by the Act. Nevertheless, for the types of fraud that are covered by the False Claims Act in the US, private and public enforcement capability has been considerably enhanced.

Criminal cases often follow in the wake of a False Claims Act civil case. In most recent years civil recoveries in False Claims Act cases in the US have exceeded $2 billion (excluding criminal penalties). When the Justice Department decides not to take over a False Claims Act case, it is much harder for a whistleblower to win, but if they do this attracts a considerably higher percentage of the penalties the government collects. This means that whistleblowers are pushed to think twice about unmeritorious cases when Justice turns it down. And Justice is pushed to think twice about how foolish it will look if it declines to join a meritorious whistleblower suit. This is the key to the genius of the 1986 False Claims Act amendments that have led to it becoming a central tool in the fraud enforcement armoury in the US. Private and public prosecutors of fraud learn from each other; the strengths and reach of each covers weaknesses and limitations of the other. There was great insight in the ‘dual plaintiff design’ of the 1986 False Claims amendments (Bucy 2002a).

Bounties for turning in tax cheats to the Internal Revenue Service (IRS) have a very different history. US Congressional debates have tended to contempt for rewarding ‘rats’ with bounties for reporting tax cheats. So the application of the False Claims Act to tax fraud was explicitly excluded by the 1986 amendments. There had been bounty provisions in US tax law for more than a century before this (Ventry 2008a, p.
This law gave the IRS considerable discretion to pay bounties to whistleblowers. They were extraordinarily weak provisions in comparison to the False Claims Act, however, in that:

- IRS officials were reluctant to pay out under its bounty program, paying on only 6.6 per cent of claims between 1989 and 1998 (Ventry 2008a, p. 364; see also Treasury Inspector General 2006);
- When the IRS did pay out, it exercised its discretion to pay low proportions of their recoveries (2 per cent between 1989 and 1998 (Ventry 2008a, p. 364), 7 per cent in 2004 and 2005 (Novack and Barrett 2009)) in comparison to up to 35 per cent in False Claims Act practice;
- Where there was a payout, on average it was received 7.5 years after lodging the claim (Ventry 2008a, p.363);
- Whistleblowers have lost 19 out of 19 court cases contesting IRS decisions to refuse to pay a bounty for information provided, or arguing for a higher level of bounty (Ventry 2008a, p. 365);
- Until 1989, bounty payouts were capped by law at $50,000 and until 2006 at $2 million. In comparison, False Claims Act payouts are not capped and sometimes exceed $100 million;
- The IRS did almost nothing to publicise its bounty program and to encourage whistleblowers to use it until its 2006 reforms;
- Whereas whistleblowers and the specialist law firms that support them can run their own civil suit under the False Claims Act if the Justice Department declines to take over their case, when the IRS decides not to pursue a bounty case the whistleblower is left high and dry.
It is therefore no surprise that there has not been the boom in bounty payouts associated with successful IRS litigation that there has been with False Claims Act frauds. There has been a considerable increase in whistleblowing to the IRS since 2006 reforms that established a Whistleblower Office within the agency and that uncapped whistleblower payouts to at least 15 per cent of recoveries in large cases. During 2008, 1,246 whistleblower allegations came into the office claiming more than $2 million in unpaid tax, with 64 of them claiming the information was worth more than $100 million, a couple of them more than a billion, one of $4.4 billion (Hilzenrath 2010; Finet 2007a, 2007b, 2008). The Treasury Inspector-General (2006, pp.1-5) concluded that tax return examinations triggered by private informants were almost twice as efficient in dollars recovered per hour of tax examination compared to examinations occasioned by standard IRS targeting from statistical risk analysis. While this is encouraging, as of May 2010, no reward had been paid by the new Whistleblower Office (Hilzenrath 2010).

Dennis Ventry (2008a, 2008b) seems justified in arguing that while there has been some significant progress in eliciting insider information as a result of the 2006 reforms, they do not go as far as qui tam under the False Claims Act. And the reforms are therefore not likely to have the success that the False Claims Act has had with other areas of fraud against government. Ventry (2008a) has also made the most important contribution to the literature in showing that legitimate concerns about privacy, conflicts with professional duties to protect confidential information, vexatious or frivolous claims, whistleblowers tainted with illegality and

---

2 Rewards can be lower than 15 per cent if it is determined that the information was partially already in the public arena or if the whistleblower was not blameless in relation to the tax conduct.
whistleblower victimization can be satisfactorily addressed in ways similar to the means that have been used for addressing them with other types of frauds (see also Bucy 2002a, 2002b, 2004a, 2004b). Likewise, earlier advocates of *qui tam* in tax enforcement such as Joshua Rosenberg (1996) and Brent Fisse (Fisse and Braithwaite 1983: 251-254, 283) and the architect of the False Claims Act reforms of 1986 and the Whistleblower Office reforms of 2006, Republican Senator Charles Grassley, pushed what increasingly appears to be a strategic reform for flipping markets in vice to markets in virtue (see also Hood (1986) for an early contribution on privatised tax enforcement).

It is time for us to reinterrogate the earlier literature on private bounties for corporate crime more generally (Crumplar 1975; Fisse and Braithwaite 1983: 251-254, 283; Sims 2002: 736) that advocated the application of *qui tam* not only be widened to tax, but to occupational health and safety, all forms of corporate crime in the pharmaceutical industry, environmental crime and corporations and securities offences (Bucy 2002a; see also Braithwaite 2008, pp. 68-85). Like Dennis Ventry (2008a) in relation to tax, Pamela Bucy has made a huge contribution to working through the implementation problems with *qui tam* across many of these areas, developing detailed policy adjustments that might respond to them. Given the success of the False Claims Act in the US, it is surprising that other nations have not attempted their own experiments with *qui tam*.

We are only beginning to learn in the business regulation literature what might be the most productive forms of hybridity between public and private enforcement. That learning will require us to attend to failed experiments such as US tax penalty
bounties to whistleblowers between 1869 and 2006, and successful ones such as the 1986 amendments to the False Claims Act. In that project, no issue requires more attention than how to secure productive synergy with other potential contributors to a web of influences to flip markets in vice back to markets in virtue. In the next section we pay particular attention to the risk of qui tam crowding out productive forms of restorative justice unless it is well designed.

Restorative Justice

Restorative justice is a forward-looking alternative to punitive justice. Instead of holding offenders responsible for crimes of the past (passive responsibility), it seeks to persuade them to take responsibility for putting things right into the future (active responsibility) (Bovens 1998). It seeks to restore victims, offenders and communities. Stakeholders in an alleged injustice sit in a circle to discuss the harm that has been done and arrive at an understanding of its nature, take responsibility for it, and then agree on a set of reforms to prevent recurrence, as well as to repair past harm. Restorative justice is about earned redemption. For corporations, that usually means seizing the opportunity to become an industry leader and educator in compliance professionalism (Parker 2004).

When investors in illicit tax schemes face bankruptcy, divorce, depression, even suicide, as the Centre for Tax System Integrity found happened to a troubling degree in the Australian tax shelter boom of the late 1990s, the public interests at stake are wider than the integrity of the tax system (Murphy 2003a, 2003b, 2004). Rituals of healing are needed after such terrible life events. There is now a lot of experience in helping people move on with their lives from restorative justice practice and evidence
that doing so builds perceptions of procedural fairness and commitment to comply in future (Braithwaite 2002). Here the tax enforcement community needs also to take note of the wider literature on therapeutic jurisprudence, on the imperative to design legal institutions that do less damage to the health of people caught up in it (e.g., Wexler 1990; Wexler and Winick 1991a, 1991b, 2000).

Another kind of case where the social damage at risk justifies investment in restorative justice is with the Arthur Andersens of aggressive tax planning. Braithwaite (2005) argued that heavy promoter penalties would have been needed to motivate a firm like Arthur Andersen that had been in trouble with tax authorities in the 1990s to sit in the restorative justice circle out of fear of those penalties, or fear of suspension of their licence for tax practice. The seemingly implausible idea proposed by Braithwaite (2005) was that the collapse of Enron and Worldcom (firms so recklessly audited by Arthur Andersen that criminal charges caused Arthur Andersen to collapse as well) might have been prevented by the Australian Tax Office (ATO). How?

When Arthur Andersen partners came to senior ATO officials in the 1990s and apologised for the conduct of a ‘rogue partner’ who had allowed serious tax misconduct to occur, that was the time to sit in the circle with all partners of the firm to discuss the culture of compliance and business integrity within Arthur Andersen. It would have been revealed that the ‘rogue partner’ was not a rogue partner at all but manifested what had become the core culture of Arthur Andersen. The ‘rogue partner’ would have defended themselves by explaining this was what they were trained and expected to do. Some of their friends within the firm might have supported them in
this. Perhaps more importantly, some retired old hand who had mentored the ‘rogue partner’ could be brought by that partner into the restorative justice circle as a supporter. He or she might argue in the process of supporting the rogue partner that the compliance culture at Arthur Andersen’s had changed for the worse. The idea is that this might have triggered a thorough internal investigation into the compliance culture of Arthur Andersen’s conducted by outside counsel.

A model that influenced those of us who have argued for this kind of approach for decades was John J. McCloy’s (1976) report into the pattern of foreign bribery indulged by executives of the Gulf Oil Corporation in the 1970s (Coffee 1981, pp.429-434; Fisse and Braithwaite 1983; Gruner 1988). It has to be said that the self-investigations led by outside counsel and the Corporate Integrity Reports since, many triggered by False Claims Act suits, have not achieved the penetration and transformation of the McCloy Report. Some of the early Australian experiments with restorative justice in competition and consumer protection law enforcement two decades ago did show some McCloy-style promise (Fisse and Braithwaite 1993; Parker 2004). Yet as in the US with Corporate Integrity Agreements, so in Australia with the spread of Enforceable Undertakings settled with companies in antitrust, consumer and environmental protection, securities fraud and occupational health and safety, restorative justice has lost its edge and innovation. It has become either forgotten or routinized in Australian business regulation, templated by compliance practitioners who take clients in trouble with a regulator through the hoops to be jumped in an enforceable undertakings process.
Part of the problem here has been an absence of third parties in the process. Environmental groups have been little involved in the meetings where enforceable undertakings for environmental offences have been agreed. With tax, there is no natural NGO to sit in a circle with an Arthur Andersen that has been behaving badly on Australian tax compliance. There was no NGO that might have pushed the ATO to demand a global McCloy-style investigation into how devoid of integrity and law-abidingness the Arthur Andersen auditing culture had become worldwide. One solution is to have a restorative justice unit within a tax authority. Its public justice ethos might be energised by the global social movement for restorative justice. That social movement would be the outside third party to push the tax authority to move onto the bigger social justice problem they had a chance to fix in the 1990s with Arthur Andersen. The idea is that anyone within the tax authority confronting any non-compliance problem could ask the restorative justice unit for assistance in setting up a restorative justice conference to transform a corporate culture and/or to help to heal those hurt by a tax enforcement process.

Such restorative justice units are to be found scattered across other contexts in Australia. There is one in the author’s home town, Canberra, where the Australian Capital Territory government funds its Restorative Justice Unit to assist with conferences initiated from anywhere in its justice system – police, prosecutors, judges, corrections – or even from civil society institutions dealing with problems like violence – such as schools, shelters or families. The New South Wales prisons system also has a restorative justice unit that can convene conferences following riots, acts of violence within a prison, alleged injustices against corrections staff by the
administration or concerns of victims about whether they will be safe when an offender who victimized them is returned to the community.

We cannot be excessively ambitious about the prospects of restorative justice reform in the here and now for a problem like tax compliance. Rather, the priority is for people like the author, who see the promise of restorative justice for a more decent society with more decent business regulation, to concentrate their efforts on building the global social movement for restorative justice. In turn that social movement is perhaps best to concentrate on restorative justice programs in schools to respond to problems like bullying, so that all children might be given the opportunity to learn to be democratic, to learn how to activate their consciences about justice in a restorative circle. Perhaps it is only when such children become senior tax officials that organizations like the ATO will be ready for the kind of restorative justice circle that might have saved Arthur Andersen and its tens of thousands of employees from themselves, and that therefore might have saved Enron, Worldcom, HIH, Onetel and other companies that collapsed in the bear market of 2001 (the ‘tech wreck’) because they were so recklessly audited by Arthur Andersen. Still, we can hope and expect that here and there some business regulators continue to experiment with restorative justice. And we will learn from their innovation in finding better paths to counter crises of capitalism.

As with *qui tam*, so with restorative justice, we should see ourselves as in an era of experimentation, not one where we have all the answers. We will make mistakes, are making mistakes, in our restorative justice experiments and learning from them. All this essay seeks to achieve is to open our minds to the potential for restorative justice
and *qui tam* working in tandem to achieve a more decent capitalism where we might be more successful in flipping markets in vice to markets in virtue.

With ‘mom and pop’ tax scheme investors who are about to lose their homes, *qui tam* and draconian promoter penalties might hang over the head of their promoter and their tax adviser. Then the promoter and the adviser will come to the restorative justice conference and more readily agree to pay a share of the investor’s penalty tax and interest as an alternative to *qui tam* enforcement in the courts, promoter penalties or being struck off as a tax agent. Braithwaite (2008: Chapter 7) argues that restorative justice is of rather general relevance because our deepest disputes over injustice consistently tend to have disturbing relational meanings to disputants. Yet offenders may not commit to a restorative justice process voluntarily. That is why more effective and innovative approaches to punitive regulation such as *qui tam* are needed to increase business motivation to make restorative justice meaningful.

**Ensuring *qui tam* supports restorative justice**

One way to prevent *qui tam* from crowding out restorative justice is to give incentives to tax cheats to beat their whistleblower to the tax authority, the environmental criminal to beat their whistleblower to the environmental regulator. The incentive would be an enforcement policy that if the corporate criminal voluntarily reports their crime to the state before the whistleblower does, they will be spared *qui tam* enforcement and instead will be given the opportunity of a restorative justice conference. Such an enforcement policy gives both whistleblowers and offenders reason to report early when preventative and reparative possibilities are greater, rather than later when the firm might be facing collapse. Whistleblowers who arrive a
fraction too late might still be given a seat in the restorative justice circle convened by a regulator and might even be compensated for information and research they are able to provide to the circle if this is of probative value in transforming a corporate offender. This is already part of the dynamic of how the False Claims Act works in the US; firms can avoid the cost of *qui tam* by beating the whistleblower to the Justice Department to confess the fraud.

One referee raised a concern here: ‘I could imagine that some firms would pursue tax fraud as a way to cope with pressing concerns, with the idea that they will later own up to it, submit to a restorative justice process, and pay a small price (rather than a *qui tam* price) for their temporary indiscretions.’ This is a good point. It must be balanced with the concern that *qui tam* on a broad front would risk overwhelming the courts if confessing first and submitting to other kinds of enforcement such as restorative justice were not an option. A lot depends on how serious the punitive and reparative were the consequences of the confession and restorative justice process and how much the firm worries about heightened future monitoring of their conduct by law enforcement as a result of a fraud confession. The more fundamental point to make here, however, is that the criminological deterrence literature continues to show that deterrence is overwhelmingly driven by certainty of detection rather than severity of punishment (Braithwaite 1989:69). That is why ‘more police, less prisons’ is a central criminal justice policy debate today (see the Vol. 10(1), 2011 special issue of *Criminology and Public Policy* on ‘More, Police, Less Prison, Less Crime?’). A package of *qui tam* integrated with restorative justice actually means ‘more (private) police and more prison’ compared with the status quo. Yet it seeks to maximise detection rather than to maximise punishment by a privatisation of enforcement that
also has the effect of forcing public law enforcement to increase its investment in the public investigation and resolution of fraud cases. A final countervailing point to the undeniable validity of our referee’s scenario is the case developed empirically in Braithwaite (2002: 102-22) for a ‘Sword of Damocles’ effect when restorative justice is actually used:

Most punishments are more feared in anticipation than they are once experienced. A criminal justice system that privileges restorative justice ahead of punitive justice thereby increases the deterrent power of punitive justice through a Sword of Damocles effect (Braithwaite 2002: 122).

This connects to a more general analysis that increasing use and severity of punishment increases deterrence and also increases defiance (Sherman 1993). More punishment translates to less crime only at those points on the deterrence curve where deterrence effects exceed defiance effects, which is often only when deterrence is tyrannically high. On this analysis, trying restorative justice first gives punishment more legitimacy and engenders less defiance.

The idea is that restorative justice circles would work under the kind of framework of enforceable undertakings under Australian business regulatory statutes. This means the company must agree to sufficient compensation to victims, including victimized whistleblowers, voluntary financial penalties paid to the state, internal discipline or dismissal of responsible executives and transformation of the compliance culture of the firm to persuade judges that it is not necessary for them to impose additional criminal/civil penalties or order additional compensation to victims. Once the enforceable undertaking developed by the restorative justice circle of stakeholders is
ratified by the court, criminal penalties for contempt hang over the company that fails to implement them. The court receives reports from the regulator and from independent compliance monitors on how satisfactorily the undertakings are completed.

Indeed under my favoured model, such reports are public on the internet. Such public compliance reports encourage a market in the virtue of compliance professionalism. This idea is that if a shoddy compliance report is posted by a shoddy compliance professional, their competitors in the compliance auditing business will blow the whistle on this to the regulator (perhaps anonymously) or to the court. They have an interest in doing this to discredit or eliminate their competitor and to encourage regulators and courts to see them as a compliance auditor with higher standards. Then regulators are more likely to commend these whistleblowing compliance auditors to errant firms. Errant firms are also more likely to prefer them so that their transformation can appear credible to the regulator and to courts. When compliance reports are generally on the internet, competitors moreover have the opportunity proactively to go to firms and offer a superior service than they see in that report, a service likely to be more successful in keeping the firm out of trouble.  

3 The most interesting revelation in the documentary on the Global Financial Crisis, *Inside Job*, was that it showed the need for a radically more transparent approach to external compliance auditing. The madam of a Wall Street brothel disclosed that she had credit cards from major Wall Street firms on which she was authorised to record prostitution services as, for example, ‘payments to compliance consultants’! The further shocking revelation is that no law enforcement authorities had asked to examine these credit card records. If US law enforcement were serious about putting Wall Street criminals behind bars it would have used the strategy Rudolf Guiliani deployed in the ‘Greed is Good’ convictions that led up to Donald Levine and Michael Milkin being imprisoned. That means using comparatively minor crimes like credit card fraud to sit someone down and say you will be going to jail for this credit card fraud and you will suffer the shame of your family knowing the lurid motivation for the fraud unless you provide the evidence of more major fraud against a bigger
Joseph Murphy (see Sigler and Murphy 1988), a doyen of compliance professionalism in the US, likes to say that the way to find the firm with the most state-of-the-art compliance program is to look at firms that have been in most trouble with a regulator in recent years. So counterfactuals worth considering are these. Might Wall Street have been a better place in the 2000s had Arthur Andersen not collapsed? Was it a bad thing that competition for the business of the Fortune 500 contracted from a Big Five to a Big Four? What if Arthur Andersen had been given an opportunity to become a fifth competitor that took auditing integrity and rigor up through a new ceiling as penance for its culture of recklessness in the 1990s that many regulators could have exposed by turning over the rocks presented to them through specific cases of non-compliance? What if Arthur Andersen had been encouraged by regulators and succeeded in leading other firms, like KPMG who also behaved badly in 1990s corporate tax compliance, up through that new ceiling in audit integrity?

Restorative justice may have promise if we are committed enough to R&D on new forms of justice. But do we have a capitalism where we are capable of doing something assertive to reduce risks of crisis? To accomplish that we need first to increase the sense of spectre that hangs over the heads of firms that might not consider an opportunity for transformation, an opportunity to lead a new market in virtue. Our argument has been that *qui tam* can sit alongside other measures like heavy penalties for promoters of tax shelters and power to withdraw or suspend tax practice licences to motivate transformative leadership. As argued in footnote 1, fish in your organization. Then likewise moving up from that fish to even bigger fish in the way Guiliani did in the 1980s.
another detection-enhancing measure *qui tam* can sit alongside is the Rudolf Guiliani approach of ‘gotcha’ to a minnow who gives up a bigger fish, who gives up an even bigger fish, until eventually the greater sharks on Wall Street are netted.

In the case of the epidemic of housing mortgage defaults in the US during the mid-2000s that were the proximate cause of the Global Financial Crisis of 2008-9, Braithwaite (2008, 2009, 2010) has argued that the preventive potential of restorative justice should have been deployed. US regulators had access to good data on housing loan defaults. So the argument is that the remedy should have been to sit down with the leadership of a bank or a bank branch to express concern if their mortgage defaults in the mid-2000s were twice their state average. The suggestion is that self-investigation reports agreed in a restorative justice process and overseen by independent law/accounting firms into the reasons for mortgage default hot-spots would have revealed banks signing many ‘liar loans’. We know now that a 2006 federal Financial Crimes Enforcement Network (FinCEN) report showed a 1,411 per cent increase in mortgage-related suspicious activity reports between 1997 and 2005, with 66 per cent of them involving material misrepresentation or false documents. Then there was a further 44 percent increase between 2005 and 2006 (Nguyen and Pontell 2010). BasePoint Analytics (2007) work on 3 million loans suggested 70 per cent of early payment defaults had fraudulent misrepresentations on their original loan applications. The loans with fraudulent misrepresentations were five times as likely to go into default (Nguyen and Pontell 2010). There were public warnings from the FBI starting in 2004 that they were seeing a spike in mortgage fraud cases (Black 2009).
The most important function of business regulation is to prevent crises of capitalism before they occur. This is more important than punishing evil-doers who crawl out from the ashes of broken banks. On the radically different vision of business regulation promoted here, punitive regulation with real bite, like that delivered by the False Claims Act, is nevertheless preventively critical. That critical role is to motivate early prevention of crisis through restorative justice by hitting firms hard if they pass up the corporate social responsibility opportunity restorative justice proffers and escalating punitiveness as opportunities for reform are spurned.

At the same time, restorative justice gives criminals an opportunity for reform and redemption. An anonymous referee here made a point that was more sophisticated than my text on this point:

> It seems to me that the author is saying that the fear of severe punishment and associated stigma causes firms to get locked into deeper wrongdoing. And creating a structure that in a sense legitimates coming forward with admissions of wrongdoing reduces the tendency that firms will become entrenched in wrongdoing. The head of Satyam (an Indian computer services company) [Cohan 2009] told the press that he had wanted to undo the fraud he was perpetrating at his firm, but could not figure out how to ‘dismount the tiger without being eaten.’ It seems that the author wants to help wrongdoers like that get off their mounts.

Responsive regulatory theory argues that individuals have multiple selves in business regulatory contexts: neglectful and negligent selves, ruthless profit-maximising selves, socially responsible selves, selves that love riding the tiger and selves that
want to dismount (Braithwaite 2002, 2011). The art of effective regulation is enticing executives to put their most responsible self forward to redeem themselves by righting the wrongs of the past before they become more catastrophic wrongs. Reintegrative shaming theory (Braithwaite 1989) theorises this, building on labelling theory (eg Lemert 1967), as an aversion of permanent stigmatisation of fraudsters, opting instead for reintegration and praise for the painful journey of earned redemption.

Conclusion

Capitalism today has more vibrant markets than ever, more regulation than ever, and more opportunities for ingenious financial engineering around regulation than ever (particularly through derivatives (Partnoy 1997, 2000, 2003; Braithwaite 2008: Chapter 2). Put another way, we have more vibrant markets in virtue and more virulent markets in vice. This means more efficient production of goods that generate wealth and unprecedented proficiency in the production of bads that can destroy it by triggering incomprehensibly catastrophic crises. If we think we can manage this new intensity of markets in virtue and vice through extant risk management models, we are deluded.

We do not have the quality of insider knowledge to know where catastrophe is brewing. A radical new approach is required to draw out insider confession and contrition for playing fast and loose with new risks. Then we need to learn how to convene diagnostic conversations on how to make early prevention work to head off those looming catastrophes of gaming commercial rules. To make all of that work, we must punish very heavily those who refuse to cooperate with such early preventive diagnosis and repair of our markets. And we must be more forgiving of those who do
switch sides to the market in virtue. Here we can learn some lessons from how air safety regulators tackled the systemic risks of an incomprehensibly complex air transport system by forgiving pilots who confess near misses (Wilf-Miron et al 2003). We also need to lean on the managerial creativity of the private sector in both privatised enforcement and in compliance system design to succeed where reactive public regulators have failed. This essay is no more than a partial, preliminary attempt at exploring the role restorative justice and *qui tam* could play in such a paradigmatic transformation of business regulation.

References


