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## Flipping markets to virtue with qui tam and restorative justice

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## A B S T R A C T

Contemporary economies are characterised by a regulatory capitalism in which both markets and regulation extend their sway. Freer markets with more rules nurture markets in vice that game regulation. Tax avoidance and evasion are used to illustrate these dynamics. Yet freer markets with more rules also engender 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 virtue. 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. This option can be complemented with a more deliberative approach, restorative justice. One reason to consider this package of hybrid private–public enforcement that knows no jurisdictional boundaries is that when fraud is globalised, firms organise their affairs so that fraud is off-shore from all state regulators with an interest in exercising jurisdiction against it.

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## Introduction

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

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. When markets enhance the efficient production of outcomes which are good according to some ethical theory, these are defined as markets in virtue. When markets enhance the efficient production of outcomes which are bad according to that ethical theory, these are defined as markets in vice. Then the paper considers *qui tam*, an approach that harnesses whistle blowers by paying them a percentage of penalties imposed, as one promising tool for pushing the worst players of markets in vice to become the best players of markets in virtue. We consider how restorative justice might flip economies away from catastrophe and finally how *qui tam* might enable rather than disable restorative justice. The potential for *qui tam* to create a space for restorative justice illustrates the idea that a whole web of influences is required to enable tax administrators, like other business regulators, to flip markets in vice to markets in virtue.

As discussed in Michael Power's contribution to this special issue, under conditions of regulatory capitalism the 'legalisation of management' and the 'managerialization of law' need not be seen as contradictory trends. Instead they can be seen as mutually constituting in a world where markets penetrate the state under the mandates of the New Public Management (Klijn, 2012) and

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state meta-regulation, regulated self-regulation, infuses markets (Parker, 2004). This essay provides an example of how both phenomena can occur simultaneously. *Qui tam* involves a partial privatisation of markets for public enforcement; restorative justice stimulates conversations to catalyse the managerial imagination of the firm to craft preventive and reparative management remedies in the shadow of law enforcement.

### Regulating tax avoidance and corporate crime with markets in virtue

Tax cheating is often economically rational behaviour. For most of the common forms of tax non-compliance, odds of detection are way below 50%, while the expected punishment following detection is less than double the tax avoided. Yet the evidence from most 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 professional tax advice 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. Sakurai and 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. This demand for an 'honest, low fuss' adviser constitutes a market for tax advice that is to this extent a market in virtue.

When someone cautions 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, for example on employee work expenses, a good way to tighten it can be to get the message out to 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. Those who do not retain a tax advisor might still be cautioned 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 advisers will read about the announcement, 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 robust 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. 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. Let me explain what that means. 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. This is the sense in which the market is supply driven at first. 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 that previous clients have made a killing without the tax authority laying a hand on them, momentum in shelter sign-ups grows. It has become more demand-driven. The (false) marketing pitch in effect can then 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 advisers say no when questioned about joining the stampede. Professionals in 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 fortunes from their firms through their bonuses 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.

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, & Giladi, 2005). Regulatory capitalism is not just about more vibrant markets combined with expanding state regulation. It is also about regulation by private actors such as stock exchanges, ratings agencies, accounting firms, compliance professionals. Not all the effects of more vigorous

competition have been good, however. Stronger markets have delivered more efficient production of many things, including many things that are often viewed as bad 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 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 rational and what is irrational, 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 competitive efficiency and in circumstances where more regulatory judgments are being made about what is good and what is bad (because the number of rules grows under regulatory capitalism). 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. Braithwaite (2005) shows 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 should eliminate. Hence, a paradox of a more effectively liberal economy is that it forces us to make more judgments about vices we wish the state to regulate. Because a perfectly competitive market economy efficiently produces more vice, indeed innovates 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. Private regulators such as ratings agencies and professions also do more steering as a private response to the public demand for more regulation.

The problem of competition driving the more efficient production of bads as well as goods is a general one. My work program on this phenomenon is of general import for the social sciences, but was given birth in the study of taxation. The plan is to move onto other phenomena, starting with a book on pharmaceuticals soon to be completed with Graham Dukes and James Moloney. The pharmaceutical industry more than a century ago conducted the R&D

on heroin and cocaine as legal drugs. In the twentieth century these drugs become intensively regulated. Yet the dilemma continues of an industry that today produces goods that conquer disease and bads that deliver a culture of a little pill for every ill, and an epidemic of legal abuse of psychotropic drugs. To the extent that competitive markets succeed in delivering the more efficient satisfaction of freely chosen preferences, they will more efficiently produce bads as well as goods – however bad and good are defined. Those who believe cocaine is good for people may think that certain legal drugs are bad for them, and vice versa. Whichever drug each considers good will be more efficiently produced and marketed in a competitive economy, but so will the drugs each considers bad. Each will see a market in virtue and a market in vice, even though they have contrary views on which are the goods and the bads. When heightened national drug enforcement bans a drug of addiction, new ones are synthesised that are not covered by drug law, and drug value chains are organised with a transnational coherence that can defeat the national coherence of regulators.

Consider a further application to derivatives (Braithwaite, 2008, chap. 2). Derivatives can do good in allowing firms to manage volatility in exchange rates or commodity prices. Yet another way derivatives are used in contemporary capitalism is for financial engineering around regulatory risks. Derivatives allow managers to avoid the need to manage risks by shifting risks instead. The financial crisis of 2008 appears to be based on thousands of US mortgage brokers and banks conspiring in fraudulent misrepresentations on loan applications. They were not too worried that their bank was lending to people who were bad risks because they sliced and diced the loans and sold the slices to hundreds of other banks as derivatives. The historically new market in financial engineering made it cheaper for US banks to securitize and spread risks than to manage them. Of course there were many other causes of the Global Financial Crisis. It is not the purpose of this article to pronounce on which were the most important.

So please step back from how much you disagree or agree with my specific analysis of the risk shifting society and the Global Financial Crisis. Return to the analytic point. If you accept that markets since the 1970s have become more internationally competitive, more vibrant and innovative, including in the financial sector; if you accept that in some contexts derivatives are goods and in other contexts bads, even though you and I might disagree on where to draw that line; then, it is analytic that those more vibrant markets will increase the risk to the world system of the more efficient production of bads, just as it will increase the benefits to the system of the more efficient engineering of good derivatives. This is to say that regulatory capitalism engenders new kinds of risks because it drives the more efficient production of newly invented kinds of bads, whatever good it does at the same time.

Of course you will not reach this conclusion if you think it untrue that the finance sector has been swept by more vibrant competition that has driven innovation in financial engineering. You will not reach this conclusion if you think all derivatives are always goods. But if you think they are sometimes bads then you must share these worries about

new financial products engineering their way around old laws and then being widely marketed, thereby stimulating potential to cause new crises.

State regulators or private ratings agencies have trouble keeping ahead of the financial engineering rocket scientists of derivatives and tax shelters. This is because if a state regulator is smarter than the rocket scientists, the market for financial engineering pays her an extraordinarily high price to defect from being a regulator. This happens quite often in the market for tax shelters. Yet tax experience shows that this basis for pessimism can be countered when the most strongly demanded markets become markets in virtuous tax advice (that eschew evasion and aggressively gaming the spirit of the law). There is no inevitability about this accomplishment. It requires deft practice of the art of tax administration. In the next section we consider how deftness can be accomplished. Flipping to markets in virtuous tax advice was achieved in Australia in the 1990s and 2000s (Braithwaite, 2005) and tax administration has some instructive lessons to teach across all the dilemmas of regulatory capitalism. Another reason for this is that tax law and tax accounting practice is more technically complex and sophisticated than most professional work. One does not hear references to rocket scientists of criminal law, constitutional or land law. The very sophistication of the markets in vice and the markets in virtue that can be discerned in tax practice makes the dilemmas posed by these markets more visible to the policy analyst than in most fields.

### Flipping markets in vice to markets in virtue

Braithwaite (2005) discussed a variety of strategies for flipping markets in vice to tax virtue. These included promoter penalties, targeting the clients of A lists of aggressive advisers (to shift demand to the advice market in virtue), 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 strategy not developed on the 2005 list – *qui tam* suits. These turn out to be instructive examples because of policy synergies enabled by their very different features. ‘What works?’ in the Centre for Tax System Integrity evaluations 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 strategies selected in this paper are selected because there is a need to make concrete the abstract idea of webs of strategies that together can flip markets from vice to virtue, and because of a belief that the contribution these two strategies have made, and might 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 at getting inside information into the hands of the law. 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 hac parte sequitur*, which means ‘He who brings an action for the King as well as for himself’. *Qui tam* had a long history in British and US law, but was 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 onto criminal prosecutions. The other area where the False Claims Act has had a transformative enforcement impact is defence contracting fraud. For the types of fraud that are targeted 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 higher percentage of the penalties the government collects. This means that whistleblowers are pushed to think twice about an unmeritorious case 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 view with contempt

attempts to reward ‘rats’ 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. 360). This law gave the IRS considerable discretion to pay bounties to whistleblowers. They were, however, extraordinarily weak provisions in comparison to the False Claims Act (Ventry, 2008a).

Consequently, 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 uncapped whistleblower payouts to at least 15% of recoveries in large cases.<sup>1</sup> During 2008, 1246 whistleblower allegations came into the office alleging 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 (Finet, 2007a, 2007b, 2008; Hilzenrath, 2010). 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. 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. Importantly, Ventry (2008a) shows that legitimate concerns about privacy, conflicts with professional duties to protect confidential information, vexatious or frivolous claims, whistleblowers tainted with illegality and whistleblower victimisation 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 & Braithwaite, 1983, pp. 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.<sup>2</sup> It is time to reinterrogate the earlier literature on private bounties for corporate crime more generally (Crumplar, 1975; Fisse & Braithwaite, 1983, pp. 251–254, 283; Sims, 2002, p. 736) that advocated widening the application of *qui tam* not only to tax, but to occupational health and safety, all forms of corporate crime in the pharmaceutical industry, environmental crime and corporations and securi-

ties offences (Bucy, 2002a; see also Braithwaite, 2008, pp. 68–85).

Like Ventry (2008a) in relation to tax, Pamela Bucy has worked through the implementation problems with *qui tam* across many of these areas, developing detailed policy adjustments that might respond to potential problems. 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 what might be the most productive forms of hybridity between public and private enforcement in business regulation. That learning will require us to attend to failed experiments such as US tax penalty bounties to whistleblowers between 1869 and 2006,<sup>3</sup> 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 (which looks back to decide the right punishment for past behaviour). 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 in the Australian tax shelter boom of the late 1990s, the public interests at stake are

<sup>3</sup> Among the reasons for that failure were: (1) IRS officials were reluctant to pay out under its bounty program, paying on only 6.6% of claims between 1989 and 1998 (Ventry, 2008a, p. 364; see also Treasury Inspector General 2006); (2) When the IRS did pay out, it exercised its discretion to pay low proportions of their recoveries (2% between 1989 and 1998 (Ventry, 2008a, p. 364), 7 per cent in 2004 and 2005 (Novack and Barrett, 2009)) in comparison to upto 35% in False Claims Act practice; (3) Where there was a payout, on average it was received 7.5 years after lodging the claim (Ventry, 2008a, p. 363); (4) 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); (5) 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; (6) The IRS did almost nothing to publicise its bounty program and to encourage whistleblowers to use it until its 2006 reforms; (7) 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.

<sup>1</sup> Rewards can be lower than 15% 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.

<sup>2</sup> See also Hood (1986) for an early contribution on privatised tax enforcement.

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 & Winick, 1991a; Wexler & Winick, 1991b, 2000).

Another kind of case where the social damage at risk justifies investment in restorative justice is with the Arthur Andersen's 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 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 audited by Arthur Andersen, 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 (cf Gendron & Spira, 2010; Toffler & Reingold, 2003; Unerman & O'Dwyer, 2004). 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 into the restorative circle by that partner 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 conducted by outside counsel.

McCloy's (1976) report into the pattern of foreign bribery indulged by executives of the Gulf Oil Corporation in the 1970s gave great impetus to policy thinking about self-investigation reports by outside counsel (Coffee, 1981, pp. 429–434; Fisse & Braithwaite, 1983; Gruner, 1988). Some Australian experiments with restorative justice in competition and consumer protection law enforcement two decades ago did show some McCloy-style promise (Fisse & Braithwaite, 1993; Parker, 2004). Yet as in the US with Corporate Integrity Agreements (Ford & Hess, 2009, 2011), so in Australia with the spread of Enforceable Undertakings settled with companies in anti-trust, 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 hoops to be jumped in an enforceable undertakings process.

Part of the problem 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 a tax practitioner that has been behaving badly. There is no NGO that might demand a global McCloy-style investigation into the integrity and law-abidingness of a firm of tax advisors. 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, engaged with tax justice civil society networks. 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.

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 those of us 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 tax authorities 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 saved the companies that suffered from its auditing failures. Still, we hope and expect that here and there some business regulators continue to experiment with restorative justice, that new generations of McCloy's will rise. And we will learn from their innovation in finding better paths to counter crises of capitalism.

### Ethical cosmopolitanism

Scholars have a role in opening the imaginations of social movement activists to options for struggle to secure more ethical business in conditions of regulatory capitalism. Consider the opportunities for ethical conversation that scholars and social movement actors might lead by contemplating BCCI (Arnold & Sikka, 2001). In 1988 Florida prosecutors in Tampa indicted a company called BCCI (Bank of Commerce and Credit International), which had become the 7th largest bank in the world by assets, for a nest of major financial crimes. BCCI was set up so it was effectively off-shore in every country where it operated.

After years of investigation and a 6-month trial, some BCCI officers were convicted and the company pleaded guilty to limited money laundering offences. Fisse and Braithwaite (1993, pp. 222–227) lamented that the prosecutor did not demand a McCloy-style report. There was good reason to do so as there was more than probable cause for believing that BCCI had become the banker of choice for the world's major criminals. It was known by the CIA Director and many others in the 1980s as the 'Bank of Crooks and Criminals International'. It laundered money for Manuel Noriega (former Panamanian dictator, now in a US prison for drug offences), Saddam Hussein, Liberian dictator Samuel Doe, Bangladesh coup leader Husain Muhammad Ershad, the Medellin Cartel and other drug traders, Abu Nidal and other terrorist groups, and laundered money for illegal arms trading and covert nuclear programs. Many believe that the head of Saudi Arabian intelligence, Kamal Adham, who secured a cosy plea agreement in 1992 (after his retirement) with the New York District Attorney for his criminal activities with the bank, pulled the strings. The CIA used the bank to fund the mujahidin in the Afghan war against the Soviet Union, laundering proceeds from their opium trading. Oliver North had BCCI accounts that were used for gun smuggling in the Iran-Contra scandal.

BCCI was finally forced to close by bank regulators from five countries in July 1991, without significant impact on the US economy, but endangering the British financial system and parts of the Arab world, affecting a million depositors worldwide, pushing countless small businesses into bankruptcy. The Fisse and Braithwaite (1993) argument was that a McCloy-style report ordered as part of the settlement of the Florida criminal case would have easily revealed a pattern of criminal money laundering that should have been stopped before more harm was done. Prudential regulators in the UK and Abu Dhabi might then have stepped in before 1990 to bring the bank onshore, manage reorganisation into non-criminal management before it collapsed and destabilized the international financial system. New York District Attorney Morgenthau revealed why it would have been easy to get insiders to spill the beans: 'A lot of them were angry. They were told they were shareholders... Then they found out they weren't' (Adams & Frantz, 1992, p. 298). Prosecutors in other countries such as England, Kenya, Brazil, Colombia, Sudan and Mauritius had opportunities to put such disaffected officers in a restorative justice circle, to be cosmopolitan prosecutors of BCCI financial crimes they had detected by demanding a holistic McCloy-style investigation. So did other US prosecutors spurn that opportunity, including one in Philadelphia in 1987 who investigated BCCI for illegal financing of US nuclear materials transfer to the Pakistan Atomic Energy Commission (Fisse & Braithwaite, 1993, p. 225). It was no surprise that the writings of obscure foreign scholars raised not a ripple of interest from good citizens of Florida and elsewhere who had enough to worry about without calling their prosecutors to account for missing an opportunity to prevent misfortune for small businesses on the other side of the world. Perhaps it is unrealistic to expect ethical cosmopolitanism of the sort McCloy showed with Gulf Oil to rise again.

Today, it is possible to reveal the mirror image of the plea to US citizens to demand ethical cosmopolitanism of corporations and prosecutors alike. On 21 August 2009 Australia suffered an off-shore blowout from a drilling platform in the Timor Sea that could not be capped for 74 days. The diagnosis was that the defective concrete base of the oil well installed by the Houston-headquartered Halliburton Co caused the spill (Bradshaw, 2010; Gold & Casselman, 2010). This revelation was not internationalised at the time. The Australian regulator could have insisted, as part of its enforcement response, that Halliburton retain engineering consultants to investigate whether off-shore wells it had cemented worldwide posed like risks elsewhere on the world's oceans. The historical record shows that the Australian regulator did not do so and the next year a British Petroleum deep-sea drilling base cemented by Halliburton also failed many months after the Timor Sea disaster, causing a like environmental catastrophe in the Gulf of Mexico. The Deepwater Horizon spill beat the Timor Sea record, taking 86 days to cap. Given that Halliburton dominates the world's well cementing business with one other company, the Timor Sea tragedy might have drawn attention to "a 2007 study by three U.S. Minerals Management Service officials [that] found that cementing was a factor in 18 of 39 well blowouts in the Gulf of Mexico over a 14-year period." (Gold & Casselman, 2010).

The globalisation of fraud, environmental catastrophe, financial crisis, tax shelters and many of the most recalcitrant vices of regulatory capitalism requires a conversation about the imperative of cosmopolitanism in law enforcement consciousness. It was within the power of Australian environmental enforcers to investigate and publicise a global risk in a way that might have prevented the Deepwater Horizon disaster and saved the lives of those who perished on that platform. It is a measure of the poverty of our global conversation about how to make business ethics work in contemporary conditions that citizens of the Gulf of Mexico are not protesting angrily about Australia's failure to adopt a more cosmopolitan ethic in its contribution to regulating the risks of capitalism.

As with *qui tam*, so with restorative justice, we should see ourselves as in an era of stimulating a richer conversation, and era of experimentation, not one where we have all or any of the answers. We will make mistakes, are making mistakes, in our restorative justice and *qui tam* experiments, and learning from them. All this essay seeks to achieve is to open minds to the potential for restorative justice and *qui tam* working in tandem as part of a web of controls 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, 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 as an alternative to *qui tam* enforcement in the courts, promoter penalties or being struck off as a tax agent. A fair criticism of restorative justice backed by *qui tam* is that while it

might tackle professional fraudsters of the scale of BCCI, it will not stop fly by nighters from flying at night. At least, however, if fraud relies heavily on professional advisors who do not take flight, a relevant target for flipping markets in vice remains in place.

Braithwaite (2008, chap. 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. Whether the allegation of serious fraud is against powerful corporations or a small-time tax evader, the early-warning insider legal threat that *qui tam* can pose may be needed to sit the organisation in the restorative justice circle in a preventative, reparative conversation before it does more fatal damage to itself and others.

### 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 were the punitive and reparative 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, p. 69). That is why 'more police, less prisons' is a central criminal justice policy debate today (see the 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, pp. 102–122):

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, p. 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. This often happens 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 business regulatory statutes. This means the company must agree to sufficient compensation to victims, including victimised 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. 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. This is one way the worst firms can be levered into the market in virtue. 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.<sup>4</sup>

Joseph Murphy (Sigler & Murphy, 1988), a doyen of compliance professionalism in the US, argues 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 rigour 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 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 extremely 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 that allows us to be 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 4, another detection-enhancing measure *qui tam* can sit alongside is the Rudolf Giuliani 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 prox-

<sup>4</sup> The documentary on the Global Financial Crisis, *Inside Job*, 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 was 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 Giuliani deployed that led up to Donald Levine and Michael Milken's imprisonment. 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 fish in your organization. Then likewise moving up from that fish to even bigger fish in the way Giuliani did on Wall Street in the 1980s.

imate cause of the Global Financial Crisis of 2008–2009, 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 1411% increase in mortgage-related suspicious activity reports between 1997 and 2005, with 66% of them involving material misrepresentation or false documents. Then there was a further 44% increase between 2005 and 2006 (Nguyen & Pontell, 2010). BasePoint Analytics (2007) work on 3 million loans suggested 70% 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 & 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 criminals who crawl 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 exec-

utives 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 approaches (Braithwaite, 1989) theorise this. They build on labelling theory (e.g. Lemert, 1967). Labelling theory points out that permanent stigmatisation of fraudsters can make crime problems worse by reinforcing criminal identities, willing law breakers to reject their rejectors and reject values of the law abiding community. Reintegrative shaming opts instead for reintegration and praise for the painful journey of earned redemption; condemnation of the crime combined with support for 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 (Braithwaite, 2008, chap. 2, Partnoy, 1997, 2000, 2003). 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, triggering catastrophic crises. I doubt we can manage this new intensity of markets in virtue and vice through extant risk management models.

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 recklessness with new risks. Then we need to learn how to convene diagnostic conversations on how to make early prevention work to head off looming catastrophes of gaming commercial rules. More than that, reforms are required that institutionalise ethical reflection within firms, that transcend the dominant ethos of contemporary capitalism that freer markets means that law and ethics are challenges to be gamed (Jackall, 1988). To make all of that happen, we must punish heavily those who refuse to cooperate with early preventive diagnosis and repair of our markets. At the same time 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, Lewenhoff, Benyamini, & Aviram, 2003).

We also need to lean on the managerial creativity in both privatised enforcement and in compliance system design to succeed where reactive public regulators have failed. The managerial creativity of markets in virtue is enabled by the freer markets of regulatory capitalism. So markets in virtue must be harnessed to enhance capitalism's ethical conversation. In that conversation, this essay has been silent on what should be settled as ethical and unethical, rational and irrational, lawful and unlawful, and when it is right to break bad laws. It has been no more than a partial, preliminary attempt at exploring the role restorative justice and *qui tam* could play as two of many needed contributors to a paradigmatic transformation of webs of business and accounting regulation.

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