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# Has the Third Circuit Effectively Eliminated the Original Source Exception to the Federal False Claims Act's Public Disclosure Bar?

**"It is the spirit and not the form of law that keeps justice alive."*[1]***

**Authored by William L. Hurlock, Esq.*[2]***

In less than six months it appears that the United States Court of Appeals has virtually eliminated the original source exception to the public disclosure bar under the Federal False Claims Act ("Act") in the Third Circuit. Significantly, two recent opinions have made it extremely difficult for whistleblowers to file cases in this jurisdiction. For those attorneys who practice in this specialized area – whether representing Relators or Defendants - it is important to understand the implications of these far-reaching decisions.

**Background**

It has long been established that an individual or entity violates the Act if they present, or cause to be presented, a false claim for payment – or if they made a false statement or record to get a claim paid – to the United States Government with knowledge of the falsity. 31U.S.C. § 3730 *et seq.* "Knowledge" can either be actual knowledge or deliberate ignorance or reckless disregard of the truth or falsity of the information.

The Act contains a *qui tam* provision that allows an individual citizen or entity, referred to as a "relator," to file suit on behalf of the Government. If successful, they receive a percentage of the recovery. *Qui tam* is an abbreviation of the Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur* which translates into "he who brings a case on behalf of our lord the King, as well as for himself." The relator may also assert personal employment claims for wrongful termination under Section H of the statute.

**The Public Disclosure Bar and the Original Source Exception**

The Act bars courts from hearing *qui tam* cases when allegations contained in the complaint are based on publicly disclosed information. This prohibition is known as the "public disclosure bar." "No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information." 31 U.S.C. § 3730(e)(4).

As stated, the public disclosure bar is jurisdictional in nature and prevents a relator from pursuing a claim. In essence, Congress intended to limit what is referred to as "parasitic lawsuits" brought by individuals who read about fraud from one of the enumerated sources listed above. For these purposes there is no difference between a *complaint* based upon information contained in public disclosures and an *amended complaint* based on such information.

As stated above, there exists, however, an exception to this prohibition. It is known as the "original source" exception. Under this exception, a relator is not barred from pursuing a matter under the Act if the relator was an original source of the publicly disclosed information. For purposes of this paragraph, 'original source' means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action. 31 U.S.C. § 3730(e)(4).*[3]*

"'Direct knowledge' is knowledge obtained without any 'intervening agency, instrumentality, or influence: immediate.'" United States ex rel. Atkinson v. PA. Shipbuilding Co., 473 F.3d 506, 520 (3d Cir. 2007). It has also been characterized as "first hand' seen with the relator's own eyes, unmediated by anything but [the relator's] own labor, and by the relator's own efforts, and not by the labors of others, and ... not derivative of the information of others." United States ex rel. Paranich v. Sorngnard, 396 F.2d 326, 336 n. 11 (3d Cir. 2005).

Furthermore, courts have held that a "relator must possess substantive information about the particular fraud, rather than merely background information which enables a putative relator to understand the significance of a publicly disclosed transaction or allegation." United States ex rel. Stinson, Lyons, Gerlin & Bustamante, P.A. v. Prudential Inc. Co., 944 F.2d 1149, 1153-54 (3d Cir. 1991). It has long been recognized that if "X+Y= Z, Z represents the allegation of fraud and X and Y represent its essential elements. In order to disclose the fraudulent transaction publicly, the combination of X and Y must be revealed, from which readers or listeners may infer Z – i.e. the conclusion that fraud

has been committed." Atkinson, 473 F.3d at 519. "To draw an inference of fraud, both a misrepresented [X] and a true [Y] state of facts must be publicly disclosed. So, if either Z (fraud) **or** both X (misrepresented facts) and Y (true facts) are disclosed…then a relator is barred from brining suit under the [FCA] unless an original source." Id. (emphasis added).

Thus, a court must determine if the allegations underlying a case have been publicly disclosed. If they have been, the court must then determine if the relator is an original source of the information supporting the allegations. A determination must be reviewed in the context of rejecting suits which the government can pursue itself, while promoting those which the government cannot. This has been the rule for some time.

**The Recent Decisions by the United States Court of Appeals for the Third Circuit**

***U.S. ex rel. Schumann***

Recently, the Court of Appeals issued two significant decisions that will seriously impact False Claims Act jurisprudence in the Third Circuit – *United States ex rel. Schumann v. AstraZeneca Pharms, L.P., et al****[4]*** and *United States ex rel. Morgan v. Express Scripts, Inc.****[5]*** Both decisions severely limited the application of the original source exception to the public disclosure bar.

In *Schuman*, relator Karl Schumann, the Vice President of pharmaceutical contracting for Medco Health Solutions, Inc. ("Medco"), alleged that the defendant pharmaceutical manufacturers improperly induced Medco to offer certain drugs; did not include those inducements when calculating best price***[6]*** for the drugs and as such, submitted inaccurate reports to the Government; overcharged the Government based on the false reports; and underpaid rebates owed to the Government based on the inaccurate best prices. He further asserted that one defendant paid Medco high rebates and fees as kickbacks while evading the best price reporting statutes. 769 F.3d at 843.

The Government declined to intervene in the case. The matter was unsealed. The defendants moved to dismiss Schumann's complaint based, among other things that his allegations were publicly disclosed and he was not an original source. Specifically, the claimed that he did not possess the direct and independent knowledge to satisfy the original source exception. Schumann countered by stating that he learned of the defendants' conduct through his position at Medco, which was not a defendant. In this position, he claimed to have reviewed confidential agreement between Medco and one other defendant providing data fees and rebates, he discussed the history of these agreements and he negotiated their extension.

The District Court dismissed the suite. Schumann appealed to the Third Circuit. In considering the arguments, that Court concluded that Schumann was ***not an original source*** of the information underlying his allegations. *Id. at* 847. Specifically, the Court reasoned that "knowledge of a scheme is not direct when it is gained by reviewing files and discussing the documents therein with individuals who actually participated in the memorialized events." *Id.* Second, Schumann's involvement in the business does not indicate he had direct and independent knowledge of any improper kickbacks or inaccurate best-price reports. *Id.* Third, Schumann's conclusions that the Defendants intended to pay kickbacks, based on his experience in the industry, does not indicate independent knowledge under the FCA. *Id.* Thus, he could not claim original source status under the Act.

***U.S. ex rel. Morgan[7]***

In *United States ex rel. Morgan v. Express Scripts, Inc.* the relator David Morgan was a pharmacist who conducted pharmacy benefit manager audits for both governmental and private clients. During his audits he discovered certain pricing discrepancies between different pharmaceutical pricing databases. He brought his findings to the Government in a *qui tam* suit. The Government intervened in part of his case against defendant McKesson Corporation settling with that defendant for $190 million.

The Government declined to intervene in the remaining part of the case. The case was unsealed and Morgan pursued the matter on a non-intervened basis. The remaining defendants - certain pharmacy benefit managers, drug wholesalers and pricing sources - filed a motion to dismiss claiming that the allegations were publicly disclosed in prior lawsuits and media publications. The District Court granted the motion.

Morgan appealed the case to the Third Circuit. In sustaining the dismissal the Third Circuit stated that Morgan's allegations were publicly disclosed and he was not an original source of the information which formed a basis for his allegations. In so holding, the Court, applying its recent *Schumann* decision, held that Morgan had "no 'direct and independent knowledge of the information on which the allegations are based." *Id.* at *3. The Court reasoned that Morgan's efforts amounted to nor more than "an eyeball comparison of two publicly available pricing listings." *Id.* at *4.

In essence, the Court held that "albeit informed by his years of experience, Morgan's assessment of publicly available information and allegedly conspiratorial communications to which Morgan was not a party is not sufficient to demonstrate the 'direct and independent knowledge' required under the FCA's original source exception." *Id.* at *6. The Court found that "Morgan was further removed from the alleged unlawful conduct than the relator in Schumann" because he was not employed by the defendant. *Id.* at *3-4. Since Morgan was not the original source of the allegations contained in his complaint, the public disclosure bar precluded his False Claims Act suit.

Based on a clear reading of these two opinions, it now appears that the Court requires that *one must work for the defendant and participate in the fraud to be considered a Relator in the Third Circuit.* However, prior to these two recent decisions, no such requirements can be found in the statute or the relevant authority interpreting the Act. Thus, one who audits an individual or entity and is not employed by them cannot be an original source. If one works in the industry, their employment is of no import unless they also specifically work for the defendant. Moreover, they must work directly in perpetrating the fraud. These two holdings severely limit the Act's application in the Third Circuit.

**Conclusion**

The False Claims Act has recently been receiving a great deal of attention – particularly in the healthcare field. These recent decisions represent a significant departure from False Claims Act jurisprudence. Conceivably it will be much more difficult to bring suit under the statute. To effectively represent clients, practitioners must be aware of their implications in bringing, or defending against, a False Claims Act case in the Third Circuit.

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[3] The statute was amended in 2010 to read as follows: For purposes of this paragraph, "original source" means an individual who either (1) prior to a public disclosure under subsection (e)(4)(a), has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based, or (2) who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action under this section. 31 U.S.C. § 3730(e)(4)(B). However, these amendments were not made retroactive. The two decisions referenced herein were filed before the enactment and, as such, the amendments are not discussed in this article.

[4] 769 F.3d 837 (3d Cir. 2014).

[5] Civ. No. 14-1029 (3d Cir. Feb. 20, 2015).

[6] Best price "with respect to a single source drug or innovator multiple source drug of a manufacturer (including the lowest price available to any entity for any such drug of a manufacturer that is sold under a new drug application approved under section 505(c) of the Federal Food, Drug, and Cosmetic Act), the lowest price available from the manufacturer during the rebate period to any wholesaler, retailer, provider, health maintenance organization, nonprofit entity, or governmental entity within the United States." 42 U.S.C. § 1396r-8 (c) (1) (C).

[7] In the interest of full disclosure, the author was one of the lead attorneys on this case.