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### Client Alert

May 31, 2007

### WHISTLEBLOWER UPDATE: SUPREME COURT REINS IN WHISTLEBLOWERS

In a case with wide-ranging import to employers working with the federal government—from health care providers to defense contractors to educational institutions—the Supreme Court last month narrowed the grounds on which whistleblower cases under the federal False Claims Act may be brought.

In *Rockwell International Corp. v. United States ex rel. Stone*, 127 S. Ct. 1397 (2007), the Court held that, to bring a whistleblower suit under the federal False Claims Act after allegations against a company have been made public, the whistleblower, or “relator” must prove that he or she has direct and independent knowledge of the allegations on which the suit is based, and that simply knowing about the allegations made public is not sufficient. By limiting the number of persons who would qualify as an “original source” of publicly disclosed allegations, the decision in *Rockwell* may deter some whistleblowers from bringing suit and provide employers additional grounds for defending these cases.

#### The False Claims Act

Whistleblower suits, under the False Claims Act, 31 U.S.C. 3729 et seq. (“Act”), have increased dramatically over the past 20 years. According to the Department of Justice, recoveries under the ACT since 1986 exceed \$12 billion.<sup>1</sup> Though much of this increase has come in the health care field, anecdotal evidence suggests further expansion will come in the defense contracting and educational fields.

The Act allows a *qui tam* suit to be brought by a private citizen (known as a “relator”) against a person submitting claims to the government. Because relators may receive up to 30% of the recovery (and attorneys’ fees) if successful, the Act provides powerful financial incentives for employees to sue employers and others who have defrauded the government. Indeed, more

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<sup>1</sup> See [www.usdoj.gov](http://www.usdoj.gov); and [www.taf.org](http://www.taf.org). “Legislative developments have resulted in an expansion of the FCA’s reach in the healthcare arena. On the defense side, contracts involving the Iraq war are ripe targets for whistleblowers.” Glenn V. Whitaker and Victor A. Walton, *The False Claims Act and its Newfound Fame*, *The Metropolitan Corporate Counsel*, Vol. 15, No. 1, January 2007 (FCA has become known to public recently and provides regulatory enforcement).

than 100 relators have received over \$1 million as their share of the recovery, and one relator received \$95 million in settlement of his suit under the Act.<sup>2</sup>

To prevent would-be whistleblowers from reading allegations in the newspaper and proceeding to file a false claims suit, the Act prohibits suits based on “public disclosure of allegations or transactions.” The Original Source Doctrine, however, allows a *qui tam* relator to bring suit based upon facts that have been made public, as long as he or she is an “original source” of the information. An original source must (1) have “direct and independent knowledge of the information on which the allegations are based” and (2) have “voluntarily provided the information to the Government before filing [a suit] which is based on the information.”

### **The Rockwell Case**

The Supreme Court’s decision in *Rockwell* followed nearly 20 years of complex litigation initiated by a former employee of Rockwell International Corp. (“Rockwell”). Rockwell operated the Rocky Flats weapons production facility under a contract with the Department of Energy (“DOE”) and earned much of its compensation from an “award fee” bonus, based on Rockwell’s performance in areas such as general management and environmental, safety and health operations.

The whistleblower, James Stone, worked at Rocky Flats from 1980 to 1986 as an engineer. In the early 1980s, Rockwell considered disposing of toxic pond sludge that accumulated in solar evaporation ponds at the facility by mixing it with cement. Stone reviewed the manufacturing process proposed, concluded that it would not work, and communicated that conclusion to Rockwell management in a written “Engineering Order.” The employer, Rockwell, disregarded Stone’s concerns and continued with the pondcrete manufacture during Stone’s employment at Rocky Flats.

On June 22, 1987, more than a year after he left Rocky Flats, Stone informed the state Bureau of Investigations about numerous environmental crimes he observed at Rocky Flats, and, based on this information, the Bureau began investigating the operation at Rocky Flats. Three days later, the allegations made against Rocky Flats were released to the media.

On July 5, 1989, Stone, using the *qui tam* provisions of the Act, filed a suit against Rockwell, alleging Rockwell concealed numerous environmental, safety and health problems from the DOE and committed numerous violations of laws, including knowingly presenting false or fraudulent claims to the government to obtain payment.<sup>3</sup>

In December 1992 Rockwell moved to dismiss Stone’s complaint for lack of subject-matter jurisdiction on the ground that Stone did not satisfy the Original Source Exception to the Public Disclosure Bar. The trial judge denied Rockwell’s motion to dismiss, finding that Stone had direct and independent knowledge that Rockwell’s compensation was linked to its compliance with environmental, health and safety regulations and that it allegedly concealed its deficient performance to continue receiving payments.

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<sup>2</sup> See McCubbins and Fitzgerald, *Qui Tam Liability*, *The Business Lawyer*, at 106 (Nov. 2006).

<sup>3</sup> Stone also delivered a confidential disclosure statement to the government, as required under the ACT. This statement identified 26 environmental and safety issues, only one of which involved pondcrete.

In November 1995 the United States intervened, and then filed a joint complaint claiming Rockwell violated the Resource Conservation and Recovery Act of 1976 (“RCRA”), 42 U.S.C. § 6928, by storing leaky, disintegrating pondcrete blocks, but did not allege that a defect in the piping system caused insolid pondcrete. Instead, the pondcrete’s insolidity was alleged to be caused by an incorrect cement/sludge ratio, as well as inadequate process controls and inspection procedures, all of which were allegedly the fault of a new pondcrete foreman.

During the 1999 jury trial, none of the documents or witnesses identified by Stone in his confidential disclosure statement was introduced at trial. The jury found for Rockwell on several counts, but awarded Plaintiffs \$1,390,775.80 on the remaining claims. After the jury verdict, Rockwell filed a post-trial memorandum arguing that Stone was not entitled to share in the United States’ recovery, because he was not an “original source.”

Rockwell appealed, and the Tenth Circuit Court of Appeals held Stone had satisfied the original-source requirement, but remanded to the district court to determine whether Stone had disclosed his information to the government before filing his *qui tam* action.

The district court found that *prior to the suit* having been filed, the “Engineering Order” written by Stone regarding the pondcrete manufacturing design had been produced by Stone and given to the government. The district court stated that the document was not specific enough about the cause of Stone’s concern to conclude that Stone had communicated facts about the claim to the government. The Tenth Circuit Court, however, disagreed with the district court judge and held that this document, received by the government before the suit was filed, was explicit in articulating Stone’s belief that the proposed design for making pondcrete was flawed.

On September 26, 2006 the Supreme Court granted a writ of certiorari on the issue of the Original Source Doctrine and on March 27, 2007 handed down its decision.

### **The Supreme Court’s Ruling on the Original Source Doctrine**

Although the Supreme Court made three holdings in this case, one will have broad implications: its holding was Stone did not meet the requirement that a relator have “direct and independent” knowledge of the information on which the allegations are based, and thus was not an original source.

First, the Court noted that to have original-source status, the relator must have “direct and independent knowledge of the information on which the allegations are based,” according to 31 U.S.C. § 3730(e)(4)(B). *Rockwell*, 127 S. Ct. 1397, 1399 (2007). The Court then considered whether “the phrase ‘information on which the allegations are based’ refer[s] to the information on which the *relator’s allegations* are based or the information on which the *publicly disclosed allegations* that triggered the public disclosure bar are based.” *Id.* at 1407.

The Court concluded that the word “information” is the “information upon which the relators’ allegations are based.” *Id.* The Court based this conclusion on the fact that subparagraph (B) requires that the relator have direct and independent knowledge of the information on which the allegations are based and provide the information to the government before filing an action based on the information. *Id.* “Surely the information one would expect a relator to ‘provide to the Government before filing an action . . . based on the information’ is the

information underlying the relator’s claims.” *Id.* The Court also noted that Congress, when writing the statute, was unlikely to have cared “whether a relator knows about the information underlying a publicly disclosed allegation . . . when the relator has direct and independent knowledge of different information supporting the same allegation . . .” *Id.* at 13.

Second, having “determined that the phrase ‘information on which the allegations are based’ refers to the relator’s allegations and not the publicly disclosed allegations,” the Court then considered “[w]hich of the relator’s allegations are the relevant ones.” *Id.* at 14. The Court held that the word “allegations does not only include those in the original complaint. Instead, it includes the allegations in the amended complaint (at the very least).” *Id.* at 15. Essentially, the Court noted that there was no limitation that would restrict the allegations considered to those in the original complaint; absent such a limitation, the Court would not imply one. *Id.* The Court further noted that it would “look to the allegations as amended—here, the statement of claims in the final pretrial order—to determine original-source status.” *Id.* at 16.

Finally, the Court considered whether Stone had original-source status in light of the above conclusions. *Id.* at 17. Because the only false claims found by the jury took place during a period between April 1, 1987 and September 30, 1988, those are the only claims to which Stone’s alleged “direct and independent information” was relevant. *Id.* The Court noted that Stone was not employed with Rockwell during that time period; thus, he could not know that the pondcrete was disintegrating or that Rockwell would fail to address the problem. *Id.*

Stone’s prediction that the pondcrete would be insolid because of a flaw in the piping system does not qualify as “direct and independent knowledge” of the pondcrete defect. Of course, a *qui tam* relator’s misunderstanding of why a concealed defect occurred would normally be immaterial as long as he knew the defect actually existed. But here Stone did not know that the pondcrete failed; he predicted it. Even if a prediction can qualify as direct and independent knowledge in some cases . . . it assuredly does not do so when its premise of cause and effect is wrong.

*Id.* at 17. Because the insolidity problem was actually caused by the new foreman’s reduction of the cement-to-waste ratio in the pondcrete, a point which even Stone acknowledged, Stone’s belief that the piping system would fail did not constitute direct and independent knowledge of the information on which the allegations were based. Lastly, the Court stated that the fact that Stone had original-source status in connection with a different claim did not provide jurisdiction “in gross” for all his claims. *Id.* at 18. The Court explained that any claim that would not have stood on its own should not be allowed to succeed simply because it is joined with another claim. *Id.*

The Court thus held, in an 8-2 opinion, that the District Court lacked jurisdiction and reversed the Tenth Circuit Court of Appeals’ judgment.

### **The Potential Impact**

Clearly, this decision should affect the number *qui tam* relator suits under the ACT. Employers targeted in future whistleblower litigation should immediately investigate the

relator's knowledge of the facts at issue, and seek to employ the principles articulated in *Rockwell* to their advantage.

Employers facing whistleblower suits should contact members of Kutak Rock's Employment Group, or Health Care Litigation Group, including the author, Thomas Kenny (with assistance from law clerk Kasey Anderson).