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CENTRAL DISTRICT OF CALIFORNIA

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MASIMO CORPORATION, a Delaware Corporation,
Plaintiff,
vs.
TYCO HEALTH CARE GROUP, L.P., a Delaware Partnership, and MALLINCKRODT, INCORPORATED, a Delaware Corporation,
Defendants.

Case No. CV 02-4770 MRP (AJWx)
MEMORANDUM OF DECISION ON DAMAGES AND PLAINTIFF MASIMO CORPORATION'S MOTION TO ACCEPT PROFFERED EVIDENCE OR SET ASIDE THE VERDICT

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I. INTRODUCTION.

The parties stipulated to a bench trial on damages in this antitrust case, which was held October 18 through October 19, 2006. The court considered further evidence and argument on the same issues on March 22, 2007. Following the trial, the parties submitted briefs, and Plaintiff Masimo Corporation ("Masimo") moved the court to: (1) accept its proffered evidence

1 of the profits it lost before July 2001; or, in the alternative, (2) set aside the prior jury verdict.
2 Based on the evidence adduced at trial and the parties' post-trial arguments, the court now
3 reaches its decision as to damages:

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6 II. BACKGROUND.

7 The court held a four-week trial of this case before a jury during February and March
8 2005. The jury found Defendants Tyco Health Care Group, L.P. and Mallinckrodt, Inc. ("Tyco")
9 liable for violations of Sections 1, 2 of the Sherman Act and Section 3 of the Clayton Act,
10 awarding Masimo \$140 million in damages on account of four of Tyco business practices which
11 were found to be anticompetitive: (1) providing *Market Share Discounts* to hospitals; (2)
12 entering into *Sole-Source* exclusive dealing arrangements with Group Purchasing Organizations
13 ("GPOs"); (3) offering *Bundled Rebates* with respect to Tyco oximetry and other products; and
14 (4) entering into *Co-Marketing Agreements* with Original Equipment Manufacturers ("OEMs").
15
16 The jury allocated the entirety of Masimo's damages to the period prior to July 2001.

17
18 Tyco subsequently filed a RENEWED MOTION FOR JUDGMENT AS A MATTER OF LAW, OR
19 ALTERNATIVELY, A NEW TRIAL ("JMOL"). In its March 22, 2006 MEMORANDUM OF DECISION
20 RE: POST TRIAL MOTIONS, the court sustained the jury's Section 1, 2 and 3 liability verdict based
21 on the anticompetitive effects of Market Share Discounts and Sole Source contracts, but vacated
22 the jury's finding of liability based on all other alleged anticompetitive practices. The court
23 further vacated the jury's total damage award as not "[y]ing] within the range sustainable by the
24 proof" and granted Tyco's motion for a new trial on damages as to the Market Share Discount
25 agreements and Sole Source GPO contracts for the pre-July 2001 damages period.
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1 The July 2001 cut-off date emerged as the most contentious issue in the October 2006
2 trial, subsequent March 2007 hearing, and related submissions. Question 14 of the Special
3 Verdict Form, titled "Damages Before July 2001," reads: "For the total damages figure you find,
4 state the amount of damages that you find occurred before July 2001?" The jury responded by
5 allocating 100% of the damages it awarded to Masimo in Questions 1 through 13 of the Special
6 Verdict Form to Question 14's pre-July 2001 damages period; i.e., the sum of \$0 (Q.1-4, Q.7-8,
7 Q.10-11, and Q.13), \$57 million (Q.5), \$57 million (Q.6), \$13 million (Q.9), and \$13 million
8 (Q.12) totaled \$140 million (Q.14).
9

10 Question 14 was solicited by Masimo and agreed to by the parties in an attempt to assess
11 a potential offset arising from an agreement they had entered into in settlement of prior patent
12 litigation in this court. Before the submission of the verdict form to the jury, the court asked
13 counsel if the jury would be able to allocate damages by time period, and Masimo's counsel
14 replied to the court: "I think they can, your Honor." Jury Trial Tr. at 3182:18-3183:16. When
15 the court revisited the issue to ask if the draft Question 14 should be submitted to the jury,
16 Masimo's counsel insisted: "I think we should go ahead and put it in." Jury Trial Tr. at 3197:25-
17 3198:3.
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19

20 Immediately following the jury trial, the court asked both parties on a telephone
21 conference if they had any difficulty in understanding the jury's special verdict. Masimo assured
22 the court that it had no problems with the verdict, as did Tyco. Indeed, Masimo unequivocally
23 assured the court, in response to Tyco's JMOL and new trial motion, that "the \$140 million pre-
24 July 2001 damage figure plainly is supported by substantial evidence." JMOL Opp. Dated
25 5/27/05 at 46.
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1 Tyco has consistently maintained that the jury's finding bars Masimo from seeking
2 damages after July 2001, viewing Question 14 as imposing a hard stop on Masimo's damages.
3 Under Tyco's interpretation, Masimo would receive no compensation for post-July 2001 results
4 of Tyco's pre-July 2001 conduct. Revenues and profits not received and booked by June 30,
5 2001 would be excluded. But, beginning at the October 2006 trial of the damages issue, Masimo
6 began to argue that the March 21, 2005 verdict not only allows, but in fact compels an award of
7 damages based on sales of both sockets and consumables lost after July 2001, but attributable to
8 contracts believed to be lost before July 2001. Masimo's counsel expounded on Masimo's theory
9 of damages at trial:
10

11 The trial here is to determine...what damages consistent with the evidence should flow from
12 what was found to be illegal before [July 2001]? And the damages that should flow from the
13 illegal conduct before that date, that harm that was caused before that date, includes the loss
14 of the sockets and the sensors that were associated with them, and it also includes sockets
15 that were lost after that date and the associated revenues of those sockets where the socket
16 was lost due to an illegal contract before that date. But certainly it applies to the second.
17 Now, those are the three categories of damages we've been discussing at this trial. And that
18 is that in dealing with this jury verdict, do you say, as Tyco says, the damages are only
19 revenues that were lost [before] July 2001? ... Alternatively, do you look at the losses of the
20 loss of the sockets, and, in addition, the reasonable expected revenue stream from the sensors
21 that was lost on the date the socket was lost.... And, third, do you look at the sockets that
22 were lost as a result of the contracts before July 2001 that were the inevitable consequence of
23 the misconduct before that date when Mr. Susman was arguing the harm occurred? And the
24 harm that occurred when the contracts were entered into as of that date.

25 Dam Trial Tr. at 188:18 to 190:4 (emphasis added). The thrust of this argument seems to be that,
26 because Masimo is "only seeking damages based on conduct before July 2001" and is not
27 "seeking damages now based on any contracts that were entered into after 2001," Masimo
28 considers itself entitled to all revenues and profits, even those not received or booked by June 30,
2001 consistent with the jury's verdict. Dam Trial Tr. at 112:13-16.

III. DISCUSSION.

1
2 The court must determine whether, in light of the jury's answer to Question 14, Masimo
3 is entitled to damages based on sales of either sockets or consumables after July 2001. In its
4 prior rulings, the court has treated the answer to Question 14 of the verdict form as imposing a
5 hard stop on Masimo's damages. It has set aside the amount of damages but given effect to the
6 finding of fact that all damages occurred before July 2001. The court observed in its March 23,
7 2006 JMOL order that "Masimo did not suffer damages after July 2001," that "the jury
8 concluded damages ceased in July 2001," and that the jury "allocated the entire damages award
9 to the pre-July 2001 time period, necessarily finding that Nellcor's conduct did not cause Masimo
10 injury post-July 2001." Further, the court rejected Masimo's MOTION TO MODIFY JUDGMENT
11 AND FOR NEW TRIAL, which claimed that the "jury's decision to allocate all of Masimo's damages
12 to the pre-July 2001 period was contrary to the evidence." Finally, the court ruled on October 5,
13 2006 – and reiterated throughout the trial of damages – that Masimo "cannot put in evidence of
14 lost profits from socket or sensor sales after July of 2001." Notwithstanding the court's prior
15 statements, the court more fully analyzes the meaning of Question 14's answer in light of all the
16 evidence adduced at trial.
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(A.) The Evidentiary Support For Tyco's Hard-Stop Interpretation.

20
21 Masimo argues that Tyco's hard-stop approach, under which Masimo would receive no
22 damages for post-July 2001 sockets or consumables or the stream of consumables associated
23 with its pre-July 2001 lost contracts, contradicts the accepted economics of the pulse oximetry
24 market. The pulse oximetry market consists of sockets and consumables, including sensors,
25 patient cables and monitors. The evidence at trial established that a stream of consumables will
26 ordinarily flow from the placement of every socket over its useful life of five to seven years.
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1 Tyco does not dispute that, prior to July 2001, a socket was predicted to produce consumables
2 sales over 5-7 years, but argues this prediction is no longer reliable given the jury's allocation of
3 all of Masimo's damages to the pre-July 2001 period. This is claimed to be consistent with, even
4 compelled by evidence that Masimo itself adduced at trial regarding the period after July 2001.

5
6 There can be no doubt that testimony given by Masimo's principal witnesses revealed a
7 dramatic change in the competitive landscape starting in July 2001. Joe Kiani, Masimo's CEO
8 and founder, confirmed at the urging of his counsel that July 2001 was a significant turning point
9 after which Masimo's "world finally change[d]." Masimo began selling direct to its customers
10 and began to utilize technologies that enabled whole house conversions of entire hospitals from
11 Tyco to Masimo oximetry. After that shift, Mr. Kiani testified that Masimo "never lost a sale."

12
13 Masimo's Radical product allowed it to convert Nellcor monitors to monitors compatible
14 with Masimo sensors by employing a simple cable. Masimo's SatShare capability combined
15 with the Radical Pulse Oximeter to convert the pulse oximetry in a multiparameter unit to
16 Masimo SET pulse oximetry. Finally, Masimo began to make multiparameter units Masimo-
17 compatible simply by swapping an inexpensive Masimo oximetry board for the original Tyco
18 board. In conjunction with Masimo's expanded roster of OEM partners and the subsequent
19 expiration of Tyco's R-Cal patent, the trial evidence suggested that Masimo successfully applied
20 these strategies and began to make substantial competitive gains over Tyco.

21
22 The potential after July 2001 for some or all of these measures to bypass or displace a
23 competitor's installed base of sockets necessarily reduces the certainty of predictions of a 5-7
24 year stream of revenues for each socket. Of course, the risk of conversion could be
25 accommodated by the application of a discount rate to reflect both the probability that
26 conversions would occur and the length of time prior to conversion during which a revenue
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1 stream from consumables would flow. The problem is that the 5-7 year socket life had
2 frequently been stated to the jury, together with evidence from Masimo's own witnesses that July
3 2001 was a watershed bringing the advent of the Radical, SatShare and a surge in competition in
4 the market. Accordingly, the jury could have reasonably concluded that, in light of the
5 demonstrated potential for whole house conversions, not shown to be possible prior to July 2001,
6 any revenue stream from consumables subsequent to July 2001 would be inherently speculative
7 and not a proper basis for an award of damages.

9 (B.) Rationalizing the Jury's Verdict.

10 The notion that the jury intended to impose a hard-stop on Masimo's damages in
11 recognition of Masimo's evidence of the feasibility of conversions after July 2001 is attractive. It
12 gives effect to the jury's finding that 100% of Masimo's damages occurred before July 2001.
13 Yet, the justification for this approach presents a further problem with respect to consumables
14 revenue.

15
16 In general, the evidence does suggest the view that the duration of the stream of
17 guaranteed consumables attributed to sockets placed before July 2001 was speculative from July
18 2001 onward. To a degree, however, the oximetry market remains a systems market in which
19 some sensor revenue would be expected to accrue to Masimo from the sockets it would have
20 placed prior to July 2001. Notwithstanding Masimo's characterization of July 2001 as a
21 watershed for the company, the record before the jury did not unambiguously establish July 2001
22 as a watershed for the oximetry market. Also, Masimo's early competitive successes, including
23 Cook County, Huntington Memorial Hospital, Pomona Valley Hospital, and others, cast doubt
24 on the reliability of the 5-7 year economic life of installed sockets. However, these successes
25 cannot themselves show that, as of July 2001, Masimo instantly acquired the capacity to convert
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1 the thousands of sockets it lost on account of Tyco's anticompetitive conduct between 1998 and
2 July 2001. In the absence of convincing evidence of a pervasive shift in the competitive
3 environment that affirmatively supports a hard cutoff, as opposed simply to undermining
4 certainty in the alternative, the hard-stop methodology would assign different economic values to
5 sockets lost at different times without sufficient economic justification. Even if such a
6 significant shift had occurred in July 2001, the risk of conversion could never rise so high as to
7 justify an estimate of the economic life of an installed socket at zero, or, put differently, render
8 the revenue from a socket's associated stream of consumables wholly uncertain. Thus, Tyco's
9 hard-stop theory risks systematically short-changing Masimo on consumables profit, however
10 minimally, for each and every socket lost.

11
12
13 With respect to lost revenue directly from sockets, however, the hard-stop theory suffers
14 from no such speculative difficulty. Masimo contends that when the jury was asked in Question
15 14 to state in dollars the "amount" of "damages" that "occurred" before July 2001, this was
16 actually a request to state the total economic value of all contracts lost prior to July 2001. If this
17 interpretation were correct, merely that a stream of consumables is speculative could not explain
18 why sockets not placed after July 2001 as a result of contracts lost prior to July 2001 should not
19 result in damages. Indeed, on this account both sales of sockets and sensors lost after July 2001
20 could result in damages. However, the court must reject this contracts-based argument as not the
21 theory of damages Masimo actually presented to the jury, nor the theory supported by any
22 evidence presented by either party. It is a paper argument that is misleading at best. The theory
23 is not made clearer by the fact that the "contracts" Masimo refers to seem at times to be Tyco's
24 illegal contracts, the effect of which lasted after July 2001, and at times Masimo's lost contracts,
25 which resulted from Tyco's illegal agreements.
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1 In any event, the statements of Masimo's lead counsel, Stephen Susman ("Mr. Susman"),
2 during closing argument provide a persuasive refutation of a contracts-based theory. In
3 discussing the final question on the verdict form as to damages found to have "occurred before
4 July 2001," Mr. Susman stated that Masimo "sustained" damages over the period from April
5 1998 to December 2004, totaling \$256 million. He then cited to Masimo's damages expert's
6 report to say that \$97 million out of \$256 million for the total time period were "sustained"
7 before July 2001. Since Tyco did not offer evidence from its expert dividing pre- and post-July
8 2001 damages. Mr. Susman stated that Tyco's expert report ignored the growth that Masimo
9 enjoyed between 1998 and 2001, "when all the harm was done to us."
10

11 Remarkably, based on Masimo's own evidence, these statements seemed to be telling the
12 jurors that they should limit Masimo's damages to the period before July 2001. In fact, Mr.
13 Susman argued this point so emphatically that the jury followed his instruction by finding just
14 that: that "all" the damages occurred before July 2001. The jury obviously interpreted Mr.
15 Susman's remarks to mean that "harm" equated to monetary damages arising from sockets lost
16 before July 2001. The record evidence from Masimo supports the conclusion that, in the period
17 after July 2001, Masimo was able to successfully compete with Tyco in the placement of sockets
18 and ceased experiencing injury as a result of Tyco's illegal conduct. At trial, the measure of
19 injury was lost sockets.
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22 The conclusion appears inescapable that the "harm" to which Mr. Susman alluded was
23 lost socket sales, all of which the jury found to have occurred before July 2001. Of course, this
24 interpretation of harm must necessarily permit Masimo's damages to include an amount of
25 consumable sales which could have been made by it after July 2001 on account of sockets lost
26 before July 2001. But the court must be careful not to overstate this harm. The harm Masimo
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1 suffered from 1998 to July 2001 was its inability to sell its sockets and profit from consumables
2 which would have flowed from those sockets.

3 The court observes, yet again, that the verdict form is lengthy and that all the answers to
4 questions other than number 14 were complete and unchallenged by Masimo. Thus, because the
5 answer to Question 14 concluding that all the "damages" occurred before July 2001 has a basis in
6 the evidence, it should be accorded a degree of deference. The answer cannot be dismissed as a
7 simple mistake when the remainder of the verdict is not claimed to be objectionable.
8

9 Accordingly, because the hard-stop approach favored by Tyco may also be reasonable if
10 understood to reflect the speculative character of downstream consumable revenues in a world
11 defined by some unknown amount of competitive swapping, the court will give effect to the
12 jury's finding in Question 14 by calculating damages in the manner set forth below:
13

14 (C.) Calculating Damages.

15 Masimo will receive damages for only sockets lost prior to July 2001. This reflects the
16 probability that the jury defined "harm" as sockets lost and intended to limit Masimo's recovery
17 for lost sockets to the pre-July 2001 period. Masimo will receive damages for sales of
18 consumables lost prior to July 2001 that are associated with sockets lost prior to July 2001.
19 Finally, Masimo will receive a heavily discounted award for sales of consumables lost after July
20 2001 that are associated with sockets lost prior to July 2001.
21

22 The court is faced with a limited universe of possible methods for calculating Masimo's
23 damages, each with significant problems that have arisen due to the evidence, testimony,
24 argument, and verdict question urged by Masimo, as Masimo has acknowledged. The court's
25 sensor stream discount option represents a "best fit" among these bad choices. It reflects trial
26 evidence suggesting a decreased likelihood of realizing a full 5-7 year sensor stream, given the
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1 rise and prevalence of whole-house conversions from one socket vendor to another and the
2 availability of third-party conversion kits that allow one company's sensor to work with another
3 party's socket. It gives effect to the jury's conclusion that it could be certain as to what happened
4 prior to July 2001, but not afterwards. It should be emphasized that Masimo encouraged this
5 belief by its own evidence, the testimony of its own economic expert, and its own arguments
6 throughout the trial.
7

8 The court's January 25, 2007 order instructed the parties to prepare, in such a way as to
9 reflect the uncertainty as to what would happen after July 2001, an estimate of the amount of
10 damages which should be awarded Masimo for consumable sales it would have made on account
11 of sockets placed before July 2001. Masimo offered only Professor MacKie-Mason's seven-year
12 stream of guaranteed consumable sales and a series of estimates that included items the court
13 previously excluded from damages in its January order. In light of the jury's finding of fact and
14 in consideration of the evidence of competitive conversions, the court finds Masimo's seven-year
15 sensor stream to be the least reasonable of the available options.
16

17 Accordingly, the court adopts Professor Ordover's methodology in its entirety. In its
18 earlier January 25, 2007 order, the court: (1) generally accepted Dr. Ordover's methodology,
19 testimony and conclusions as the most reliable basis for the award of damages in the case; (2)
20 accepted Dr. Ordover's classification of "affected" and "unaffected" hospitals and found Masimo
21 entitled to damages as to those hospitals which negotiated "stand alone" market share
22 commitments with Tyco; (3) found that the effects of bundling contracts and equipment finance
23 programs are properly excluded from the damages calculation; (4) accepted the rate used by Dr.
24 Ordover to compound future profits; and (5) accepted Dr. Ordover's findings as correctly
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1 calculating the sales of sockets and consumables that Masimo would have made before July 2001
2 but for Tyco's antitrust violations.

3 The court also adopts Dr. Ordovery's recent opinion that the "residual life" of Tyco's
4 installed base of sockets was an average of 2.5 years as of July 1, 2001, resulting in an average
5 socket life of 4.1 years for Masimo's lost sockets. Masimo complains that Professor Ordovery
6 merely replaces one hard stop with another, one no less artificial, and no more reasonable. This
7 criticism is not persuasive. Masimo had a full and fair opportunity to propose an alternative
8 consistent with the court's observation that there is "evidence in the record that could lead to the
9 conclusion that there could be no guaranteed stream of income from a socket." It made a
10 strategic choice to rest on seven years; but, in light of the verdict and the evidence available to
11 the jury, seven years is unreasonable, and the court accepts the alternative – provided by Tyco.

14 (D.) The Proffer.

15 Masimo has moved the court to accept its proffered evidence of damages incurred after
16 July 2001 as a result of harm suffered before July 2001. This motion is denied. First, the court
17 has already considered those portions of the proffer substantively relevant to the instant damage
18 award; that is, relevant to the stream of lost sensor revenues after July 2001 attributable to
19 sockets lost prior to July 2001. The remainder is duplicative or immaterial. Second, as Masimo
20 has acknowledged, it was the testimony of Masimo's own expert at the liability trial, Dr.
21 Leitzinger, which was "the sole basis for allocating pre- and post-July 2001 damages." "[I]t
22 remains undisputed," Masimo argued, "that [Dr. Leitzinger] was the only person to allocate
23 between the pre- and post-July 2001 period at the jury trial." Masimo cannot now be heard to
24 complain that it was denied an opportunity to introduce evidence on this allocation, or on the
25 magnitude or duration of the guaranteed stream of income from any sockets lost. Indeed,
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Masimo declined the court's invitation to present evidence of a stream of sensor revenue after July 2001 more attenuated than the seven-year economic life presented to the jury.

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IV. CONCLUSION.

Masimo's contracts-based damages theory may hold some superficial appeal, but it is not supported by the evidence Masimo presented at trial. The court must be attentive to what the jury did based on the facts and argument Masimo presented. For the foregoing reasons, the court awards Masimo damages in the amount of \$14.5 million, of which \$7.2 million are Masimo's lost profits on socket and sensor sales between April 1998 and July 2001, and the remaining \$7.3 million are damages incurred after July 2001 on foregone consumables sales attributed to sockets lost before July 2001.

ACCORDINGLY, IT IS ORDERED:

- (1) Defendants Tyco Health Care Group, L.P. and Mallinckrodt, Inc. are ORDERED to pay damages to Plaintiff Masimo Corporation in the amount of \$14.5 million.
- (2) Plaintiff Masimo Corporation's Motion To Accept Proffered Evidence Of Pre-July 2001 Damages is DENIED.

DATED: *June 6, 2007*

Mariana R. Pfaelzer
Hon. Mariana R. Pfaelzer
United States District Judge