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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

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| **Masimo Corporation,**<br>Plaintiff,<br>v.<br>**Tyco Health Care Group, L.P. and Mallinckrodt, Inc.**<br>Defendants. | CASE No. CV 02-4770 MRP<br><br>**MEMORANDUM OF DECISION RE:** Post-Trial Motions |

The parties have each filed post-trial motions. Defendants Tyco Health Care Group, L.P. and Mallinckrodt, Inc. ("Tyco") filed a Renewed Motion for Judgment as a Matter of Law, or Alternatively, a New Trial ("JMOL") and a Motion to Stay Entry of Judgment. The Motion to Stay Entry of Judgment was voluntarily withdrawn following the conclusion of patent litigation between the parties. Plaintiff, Masimo Corporation ("Masimo") filed a Motion for Entry of a Permanent Injunction. On June 28, 2005, this court heard oral argument and took the Motions under submission.

**BACKGROUND**

The court held a four week trial of this case during February and

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March 2005. Before the trial, the parties stipulated to the relevant product and geographic markets at issue in the case. The relevant product market is the pulse oximetry systems market, which consists of sensors, patient cables and pulse oximeter monitors. The relevant geographic market is the United States. Pulse oximetry involves measuring a patient's heart and lung function via a non-invasive procedure that calculates pulse and arterial blood oxygen saturation. A pulse-oximeter sensor is typically attached to the end of a patient's finger. The sensor is made up of a photoemitter that sends light through the patient's tissues, and a photodetector that measures the light transmitted through the tissue. The monitor computes the patient's blood oxygen saturation from the measured data.

Masimo claimed that Tyco violated Section 3 of the Clayton Act ("Section 3") and Sections 1 and 2 of the Sherman Act ("Section 1" and "Section 2"). Masimo identified five Tyco business practices that it contended were anticompetitive under Sections 1 and 3. These practices included: (1) providing "loyalty discounts" to hospitals in exchange for a hospital's commitment to purchase not more than a specified percentage of the hospital's requirements for oximetry products from Masimo or other competitors of Tyco ("Market Share Discounts"); (2) entering into "sole-source exclusive dealing arrangements" with hospital Group Purchasing Organizations ("GPOs") that effectively prevent Masimo and other competitors from selling oximetry products to GPO hospitals ("Sole Source"); (3) offering "bundled rebates" in which discounts on oximetry products were linked with discounts on completely unrelated Tyco products ("Bundled Discounts"); (4) entering into contracts with Original Equipment Manufacturers ("OEMs") that effectively foreclosed OEMs from manufacturing monitors compatible with Masimo and other rival technology ("Co-marketing Agreements"); and (5) entering into oximetry "equipment financing programs" that impose financial penalties on hospitals that switch to rival oximetry monitors before the expiration of financing agreements ("Equipment Financing Programs"). For its Section 2 claim, Masimo asserted that liability was based on a "monopoly broth" theory in which any of the alleged anticompetitive practices independently or in combination, resulted in a Section 2 violation.

The jury found Tyco liable for violating Sections 1, 2 and 3, but awarded damages for only the Section 1 and 3 violations. The jury awarded Masimo $140 million in damages and found that all damages occurred prior to July 2001. The jury concluded that Tyco's Equipment Finance Programs were lawful and found the remaining four practices to be both "exclusive dealing arrangements" under Section 3 and "unreasonable restraints of trade" under Section 1. The jury apportioned damages based on the effect each practice had on Masimo. The jury awarded Masimo $57 million for Market Share Discounts and $57 million for Sole Source GPO Contracts based on Section 1 liability but did not award any damages for these practices based on Section 3 liability. The jury awarded Masimo $13 million for Product Bundling and $13 million for Co-Marketing Agreements based on Section 3 liability but did not award any damages for these practices based on Section 1 liability.

**LEGAL STANDARD FOR JUDGMENT AS A MATTER OF LAW**

Tyco has renewed its motion for judgment as a matter of law under Rule 50(b) of the Federal Rules of Civil Procedure (FRCP). FRCP Rule 50(a)(1) establishes the standard by which this court must consider

Tyco's motion for judgment as a matter of law:

> If during a trial by jury a party has been fully heard on an issue and there is no legally sufficient evidentiary basis for a reasonable jury to find for that party on that issue, the court may determine the issue against that party and may grant a motion for judgment as a matter of law against that party with respect to a claim or defense that cannot under the controlling law be maintained or defeated without a favorable finding on that issue.



FRCP Rule 50(a)(1). In accordance with this standard, this court should grant Tyco's motion for judgment as a matter of law if substantial evidence does not support the jury's factual findings or if those factual findings cannot support the legal conclusions implied from the jury's verdict. *Chiron Corp. v. Genentech, Inc.*, 363 F.3d 1247, 1252-53 (Fed. Cir. 2004).

A district court may overturn a jury's verdict only if reasonable jurors could not have reached that verdict on the record that was before them. *Bell v. Clackmas County*, 341 F.3d 858, 865 (9th Cir. 2003). This court must view the evidence in the light most favorable to the non-moving party, draw all reasonable inferences in favor of the non-moving party, and consider whether there is sufficient evidence in the record to support the jury verdict. *Horphag Research Ltd. v. Pelligrini*, 337 F.3d 1036, 1040 (9th Cir. 2003); *McEuin v. Crown Equip. Corp.*, 328 F.3d 1028, 1036 (9th Cir. 2003).

**LEGAL STANDARD FOR REQUEST FOR A NEW TRIAL**

Tyco alternatively requests a new trial under Rule 59(a) of the FRCP. FRCP Rule 59(a) reads in relevant part:

> A new trial may be granted to all or any of the parties and on all or part of the issues (1) in an action in which there has been a trial by jury, for any of the reasons for which new trials have heretofore been granted in actions at law in the courts of the United States.

Under applicable law, "a new trial is proper only if the 'verdict is contrary to the clear weight of the evidence, or is based upon evidence which is false, or to prevent, in the sound discretion of the trial court, a miscarriage of justice." *Hangarter v. Provident Life & Accident Ins. Co.*, 373 F.3d 998, 1005 (9th Cir. 2004). In ruling on a new trial motion based on insufficiency of the evidence, the court need not view the evidence in the light most favorable to the prevailing party. *Landes Constr. Co. V. Royal Bank of Canada*, 833 F. 2d 1365, 1371 (9th Cir. 1987).

**ANALYSIS**

In considering the parties' motions, the court first reviews the jury's verdict with respect to liability and then examines the issue of damages and the motion for permanent injunction. The jury found Masimo did not suffer damages after July 2001. For that reason, and because Masimo did not have a product approved for sale by the FDA until February 1997 the court limits its analysis to the time period February 1997 to July 2001.

**I. SECTION 1 AND 3 LIABILITY**

Section 3 of the Clayton Act prohibits companies from making exclusive agreements that prevent buyers from dealing in the goods of a competitor where the effect of the agreements "may be to substantially lessen competition or tend to create a monopoly." 15 U.S.C. § 14. Section 3 of the Clayton Act seeks to prevent the anticompetitive effects of exclusive dealing arrangements. *See Twin City*, 676 F.2d at 1302. To fall within the purview of Section 3, the contract must be "truly an exclusive dealing one." *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. at 329-30. Exclusivity alone is not sufficient to establish an antitrust violation under Section 3; the contract must also foreclose competition. *See Tampa Elec. Co.*, 365 U.S. at 327 (even though a contract may be found to be an exclusive dealing arrangement, it does not violate Section 3 unless the court "believes it probable that performance of the contract will *foreclose* competition in a substantial share of the line of commerce affected") (emphasis added); *see also Omega Envtl. v. Gilbarco*, 127 F.3d 1157, 1162 (9th Cir. 1997) ("[T]he main antitrust objection to exclusive dealing is its tendency to foreclose existing competitors or new entrants from competition in the covered portion of the relevant market during the term of the agreement.").

The Supreme Court has explained that a contract need not include specific terms of exclusivity in order to qualify as an exclusive dealing contract under Section 3, as long as the "the practical effect" of the agreement is to exclude competitors. *Tampa Elec.* Co., 365 U.S. at 329-30 (*de facto* exclusivity is sufficient to qualify under Section 3). However, "virtually *every* contract to buy 'forecloses' or 'excludes' alternative sellers from some portion of the market, namely the portion consisting of what was bought." *Gilbarco*, 127 F.3d at 1162. Therefore, the first step in evaluating a Section 3 claim is to determine whether the challenged practice is actually an exclusive dealing arrangement. *Tampa Elec.* Co., 365 U.S. at 327, 329-30. If an agreement is an exclusive dealing arrangement, it is then analyzed under the antitrust rule of reason to determine if it has anticompetitive effect. *Gilbarco*, 127 F.3d at 1162.

Section 1 of the Sherman Antitrust Act prohibits every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce. *See* 15 U.S.C. § 1. The elements of a

Section 1 case are: (1) an agreement or conspiracy among two or more entities; (2) with the intent to unreasonably restrain competition; (3) which causes injury to competition. *See Eichman v. Fotomat Corp.*, 880 F.2d 149, 161 (9th Cir. 1989).

In cases where the business practices challenged under Section 1 are not considered per se illegal under antitrust law, the analysis of a Section 1 claim is very similar to the analysis of a Section 3 claim. Like Section 3 claims, Section 1 claims that are not per se illegal are analyzed under the rule of reason.[1] *See Twin City*, 676 F.2d at 1304; *Gilbarco*, 127 F.3d at 1162 (the rule of reason analysis used to determine a Section 1 Sherman Act violation is also the appropriate test for a Clayton Section 3 violation, citing *Twin City*); *see also Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 45 (1984)(O'Connor, J. concurring). Under the rule of reason, "[o]nly those arrangements whose 'probable' effect is to 'foreclose' competition in a substantial share of the line of commerce affected" violate the antitrust laws. *Omega*, 127 F.3d at 1162 (citing *Tampa Elec.*, 365 U.S. at 327 and *Jefferson Parish*, 466 U.S. at 45).

Although there is no set percentage for how much of the relevant market must be foreclosed, it must be substantial enough that competitors are truly "frozen out of a market." *Omega 127 F.3d* at 1162 (38% foreclosure was not actionable); *but see Twin City*, 676 F.2d at 1304 (24% foreclosure was actionable). In determining whether

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[1] The Ninth Circuit has found that exclusive dealing arrangements challenged under Section 1 are not per se violations and are evaluated under the rule of reason. *See Twin City*, 676 F.2d at 1304 , n.9 (citing *Tampa Elec. Co.*, 365 U.S. at 327). Masimo has never contended that any of the alleged practices were per se illegal and therefore the appropriate legal analysis to use in evaluating the Section 1 claims is the rule of reason.

substantial foreclosure exists, courts must evaluate whether alternative distribution channels were available, whether the challenged contracts were in practice terminable on short notice, and whether one or more competitors was able to enter or expand business in the relevant market during the time in which the challenged contracts were in effect. *Omega*, 127 F.3d 1163-64.[2]

**A. Market Share Discounts**

Throughout the trial, Masimo referenced Joint Trial Exhibit 1392, an internal Tyco strategy document. The document includes a depiction of a castle surrounded by a series of walls. The castle keep is labeled "sensors". According to Masimo, the protective walls are labeled with each of the anticompetitive practices at issue in this case and the exhibit illustrates Tyco's intent to insulate its sensor franchise from competition with the practices at issue. The court did not find the exhibit as persuasive as the jury apparently did and reviews the accused practices individually.

The evidence established that Tyco offered hospitals increased discounts on the purchase of pulse oximetry sensors in exchange for a hospital's commitment to buy a greater percentage of its oximetry needs from Tyco. Masimo argued these contracts prevented hospitals from purchasing more than small amounts of their oximetry needs from other suppliers like Masimo.

During the trial, Masimo demonstrated the effects of a typical

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[2] The Ninth Circuit also has explained that it is easier to meet the threshold of foreclosure for a Section 3 violation than it is for a Section 1 violation. *See id.* at 1304, n.9 ("a greater showing of anticompetitive effect is required to establish a Sherman Act violation than a [S]ection 3 Clayton Act violation in exclusive-dealing cases.").

Market Share Discount agreement. Pursuant to an agreement with Tyco, a hospital received a 40% discount on sensors if it bought at least 90% of oximetry products from Tyco. JTX-85; JTX-335. The discounts dropped to 16%-18% on all oximetry sensors if the hospital bought less than 90%. Tr. 1743-47, 1751-55. Masimo argued that the possible loss of Tyco's maximum discounts on all of a hospital's sensor purchases functioned as a "penalty" forcing hospitals to deal exclusively with Tyco. According to Masimo, for a hospital to purchase Masimo sensors, even if they were offered at a substantially lower price than Tyco's, a hospital would have to replace some or all of its existing Tyco compatible monitors. In most cases, Masimo claimed, it could not price its sensors low enough to compensate hospitals for the cost of replacing monitors and the loss of Tyco's discounts. Opp'n. at 18, citing Tr. 443-47.

In 1997, Masimo was a new entrant into the oximetry systems market. Tyco was the well established market leader with a 15-year head start. By virtue of its earlier entry, Tyco had a preexisting installed base of oximetry monitors that had been previously sold to hospitals. As shown at trial, oximetry monitors are expensive pieces of equipment that have a usage life of 5 to 7 years. Stand-alone monitors made by a particular manufacturer are typically compatible with only one kind of sensor. Once a hospital has purchased a particular manufacturer's monitor, it must purchase compatible sensors and can only purchase non-compatible sensors if it buys additional monitors. This was the market environment in which Masimo first began to sell its products.

The jury had to decide whether Masimo's difficulties were the result of anticompetitive Market Share Discounts, or instead, whether

Masimo's difficulties stemmed from the fact that it was trying to win business from customers with pre-existing investments in a competitor's product (i.e. Tyco monitors). Irrespective of the Market Share Discounts, in most cases, hospitals already had strong incentives to buy a certain percentage of their sensor requirements from Tyco in order to support their Tyco compatible monitors. Although the court might have reached a somewhat different conclusion, the jury concluded the Market Share Discounts were anticompetitive. The jury could reasonably have reached that conclusion.

In order for the Market Share Discount agreements to be considered exclusive dealing arrangements, the agreements must, in practical effect, exclude other sellers. See *Tampa Elec. Co.*, 365 U.S. at 329-30. The jury was free to conclude that Tyco's Market Share Discounts, in practical effect, offered hospitals their best discount only if they dealt with Tyco exclusively.

The evidence, however, showed that Tyco's Market Share Discount agreements were contractually terminable by hospitals on short notice.[3] (Tr. 2438:25-2439:15, 2440:18-2441:13, 2445:1-10, 2449:21-2451:22.) In general, exclusive dealing arrangements that are terminable on short notice are not anticompetitive because foreclosure is very unlikely. *See Western Parcel* Express *v. United Parcel Service*, 190 F.3d 974, 976 (9th Cir. 1999); Concord *Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1062-63 (8th Cir. 2000). Even if a buyer has an agreement to purchase 100% of its requirements from a single supplier, if the buyer is free to terminate the agreement on

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[3] The ability of hospitals under Sole Source contracts to terminate Market Share Discount agreements on short notice is discussed separately under the next subsection.

short notice, the agreement is generally not anticompetitive. In the absence of long-term commitments, an efficient competitor can offer a competitive price at any time and win the buyer's business.



Although the Market Share Discount agreements appear to have been terminable on short notice on their face, the jury could reasonably have concluded that in practice they were not. A number of hospitals were financially locked into purchasing a fixed amount of Tyco sensors to support their installed Tyco monitors. These hospitals were locked into those purchases for the duration of the useful life of their installed Tyco monitors. This fixed demand for Tyco sensors for an extended period of time, when combined with the Market Share Discounts, effectively prevented the hospitals from purchasing sensors outside of the Market Share Discount agreements on short notice. The jury therefore, could reasonably conclude those agreements were defacto exclusive.

Tyco argues that *Omega Environmental., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157 (9th Cir. 1997), comprehensively addresses what evidence is sufficient and insufficient to sustain a jury verdict of foreclosure in an exclusive dealing case. In that case, the court concluded that exclusionary agreements that foreclosed 38% of the market did not, as a matter of law, substantially foreclose the market. The court based its decision on two primary factors. First, the court held that agreements with distributors "are generally less cause for anticompetitive concern" because they do not necessarily foreclose competitors from reaching end-customers directly. *Id.* at 1163. Second, the court held that the "short duration and easy terminability" of the agreements at issue in the case "negate substantially their potential to foreclose competition" because the termination provisions allowed the plaintiff to induce switching by offering a better product or a better deal." *Id.* The Market Share Discounts at issue in this case were made directly with hospitals and as previously discussed, the agreements were not in practice terminable on short notice.

In *Twin City Sportservice v. Charles O. Finely & Co.*, 676 F.2d 1291, 1298 (9th Cir. 1982), the Ninth Circuit found that where an exclusionary agreement was not terminable on short notice, market foreclosure of 24% was sufficient to trigger Section 1 and 3 liability.[4] Ample evidence was introduced at trial showing that Masimo was not foreclosed from all hospitals. In fact, the record shows that Masimo was able to convince a number of hospitals to replace their existing oximetry monitors with Masimo technology and from 1998 to 2001, Masimo was able to grow revenues from zero to over $14 million and capture over 10% of new oximetry monitor sales. Nevertheless, the jury could reasonably conclude from the evidence presented at trial that competitors were foreclosed from greater than 24% of the market and that the foreclosure was substantial. The jury could also reasonably conclude that the anticompetitive effects of the foreclosure outweighed the procompetitive effects of the Market Share Discounts. The jury's liability verdict with respect to Market Share Discounts must therefore, be sustained.

**B. Sole Source GPO Contracts**

The evidence showed that Tyco entered into Sole Source contracts with certain GPOs. Under the Sole Source agreements, the GPOs offered their member hospitals pre-negotiated discounts on Tyco oximetry

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[4] A Section 3 claim may be supported by less than 24% foreclosure. *Id.* at 1304 n.9.

products. Under the Sole Source agreements, Tyco was the only provider with which the GPOs had pre-negotiated discounts. GPOs function as agents for their group hospitals, investigating products and using their group members' combined power to negotiate discounts. It was the hospitals, however, that were the direct purchasers of products. At trial, Masimo focused on Tyco's contracts with three GPOs: Premier, Consorta and Novation.

The Sole Source GPO contracts, essentially, were Market Share Discount programs, like those discussed in the previous section. The only difference was that the contract terms were negotiated with GPOs, rather than directly with hospitals. Masimo argued the Sole Source contracts were exclusionary for the same reasons as the Market Share Discounts. In addition, Masimo argued the GPO contracts were exclusionary because, by their terms, they restricted hospitals from purchasing from Masimo and other oximetry providers.

There was conflicting evidence as to whether the Sole Source agreements expressly restricted GPO members from purchasing Masimo oximetry products. A reasonable jury could have concluded that agreements with Premier and Consorta were exclusionary on their face. However, a jury could not reach the same conclusion with respect to Novation or its predecessor organizations.

Evidence was presented that Premier and Consorta members were required to purchase 90% and 85%, respectively, of their oximetry products from Tyco. JTX-97, JTX-983. Evidence also was presented that members of both GPOs were prohibited from buying outside of the GPO contracts (except for allowed minimums), and that members were not permitted to belong to more than one GPO. Id. With respect to Premier, the jury also could have concluded from the evidence that hospitals that were not in compliance with GPO agreements could be penalized or ejected from the GPO. JTX-480.

With Novation, an explicit term of the GPO contract provided that no member hospital was required to buy anything from Tyco. JTX-304 at NOV000931; Tr. 1033:9-14. In addition, the Novation Sole Source agreement was not in effect until January 2001. Therefore, the Novation agreement, even if restrictive, could only have had a minimal impact on the market before the jury concluded damages ceased in July 2001.[5]

Tyco claimed that the Sole Source agreements were terminable on short notice and, therefore, under *Concord Boat*, even if the agreements were exclusionary, they were not anticompetitive. In support, Tyco elicited evidence that the GPO contracts with Premier and Consorta were terminable at will on 90 days notice. Tr. At 2448:21-2449:20, 2873:17-2874:19. This evidence, however, only demonstrates that the GPOs could terminate their agreements with Tyco. The relevant inquiry is whether member hospitals could get out of the agreements on short notice. A reasonable jury could conclude that member hospitals could not. To get out of an agreement with Tyco, a member hospital would either have to leave the GPO or ask the GPO to terminate its agreement with Tyco. A jury could conclude that neither option was a credible short-term solution. With respect to the hospitals, the GPO contracts were effectively long term. The question then becomes whether the jury could reasonably conclude that the

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[5] In ft. 9 on page 15 of the opposition, Plaintiff argues that Tyco had Sole Source agreements with VHA and UHC, Novation's predecessors. However, evidence introduced at trial, including cited exhibits, failed to demonstrate that members of VHA and UCS were required to purchase oximetry products from Tyco.

agreements foreclosed a substantial share of the market. *Omega*, 127 F.3d at 1162.

According to Tyco documents, in July 2001, Premier and Consorta membership accounted for 31% and 5% of U.S. hospitals, respectively. JTX 483. Masimo argued that these percentages actually represented an even greater portion of the overall oximetry market, because Premier included many of the country's largest hospitals which have greater oximetry needs.

Tyco contends that Masimo failed to offer evidence showing that the 36% of hospitals covered by Premier and Consorta were actually foreclosed from purchasing oximetry from Masimo or other manufacturers. To the contrary, Tyco argues the evidence showed Masimo was successful in winning 14% of targeted Premier accounts and 96% of targeted Consorta accounts. Tr. At 675:12-682:20; Plaintiff's Demo 17. Tyco claims that proof of Masimo's sales to Premier and Consorta hospitals conclusively establishes that Masimo was not foreclosed. However, a closer inspection of Masimo's success rate shows that it was calculated from a total of 22 targeted hospitals in the case of Premier and 24 targeted hospitals in the case of Consorta. In 2002, Premier had 1,473 member hospitals and Consorta had a couple of hundred member hospitals. The jury was free to conclude that the handful of accounts won at Premier and Consorta were the result of selective enforcement of the GPO contracts, rather than an indication that Masimo had the ability to sell directly to GPO members.

As with the Market Share Discounts, Tyco relies on *Omega Environmental* to argue that the evidence introduced at trial was insufficient to sustain a jury verdict of foreclosure in an exclusive dealing case. Because GPOs are not traditional distributorships like those at issue in *Omega* and because, as previously discussed, the GPO contracts were not in practice terminable on short notice, the court finds *Omega Environmental* inapplicable. GPOs do not buy, sell or physically deliver products to their members. As was noted above, GPOs function as the agents of the hospitals and pre-negotiate contract terms on behalf of hospitals, but it is the hospitals that contract directly with the sellers. The GPO contracts with Premier and Consorta were directly restrictive on the hospitals because they prevented the hospitals from purchasing more than allowable minimums of non-Tyco oximetry products. With respect to Premier and Consorta members, Tyco's competitors were foreclosed, not just from selling through GPO negotiated contracts, but from selling through any method.

*Twin City Sportservice* provides the standard for evaluating foreclosure caused by Sole Source agreements. The jury could reasonably infer that as a result of the GPO contracts with Premier and Consorta, competitors were foreclosed from greater than 24% of the market and that the foreclosure was substantial. The jury could also reasonably conclude that the anticompetitive effects of the foreclosure outweighed the procompetitive effects of the pre-negotiated discounts.

**C. Product Bundling**

The evidence showed that Tyco offered "bundled discount" agreements to GPO members, hospital networks and individual hospitals. These discounts rewarded hospitals for purchasing certain minimum quantities of a number of unrelated products. By purchasing all of the bundled products, the hospital got additional discounts above and beyond those offered in connection with the sale of each product individually. Masimo argued that in order for it to compete against bundled discounts, it would have to have sold "its products substantially below cost and, in some accounts would have been able to match Tyco's pricing only by paying the accounts tens or hundreds of thousands of dollars." Opp'n. at 20 (citing Tr. 1239-43; 1789-90).

In evaluating a Section 1 or Section 3 claim, absent evidence of a tying arrangement or predatory pricing, there is nothing problematic about a company offering increased discounts if two or more products are purchased together. *Jefferson Parish*, 466 U.S. at 11-12. Masimo did not argue that the bundled discounts were predatory or functioned as a tying arrangement and there was insufficient evidence introduced at trial to reach either conclusion.

The court could not find a case where voluntary package discounts were found to be unlawful exclusive dealing arrangements, under either Section 1 or 3. *LePage's Inc. v. 3M*, 324 F.3d 141(3d Cir. 2003), upon which Masimo primarily relies, and *SmithKline v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978), upon which the *LePage's* decision was based, both found bundling practices violated only Section 2. If a customer has the alternative of purchasing the product separately, then barring evidence of predatory pricing or tying, offering customers the product in a package does not constitute a restraint of trade under Section 1 or 3. Insufficient evidence was presented for a jury to reasonably conclude that the bundling programs were compulsory, predatory in nature or tying arrangements.

Additionally, Masimo's expert estimated that 30% of oximetry sales were affected by bundling practices. Tr. 1782:25-1783:5. The expert included Novation's bundling programs in his estimate, however the Novation bundling agreement did not go into effect until April 2001. Because the jury found all damages occurred prior to July 2001, the Novation bundling program was only in effect for 4 months before that date. The 30% potential market foreclosure figure therefore, appears to have been overstated.

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The evidence also showed that bundling programs varied widely in terms of the number and types of products included, as well as in the amount of the discounts that were offered. Some bundles even included products from manufacturers other than Tyco. Even if the jury could have concluded certain bundles were anticompetitive, it was impossible for the jury to determine, even in general terms, how much of the bundled oximetry sales were sold in connection with anticompetitive bundling practices as compared to legal bundling practices.

**D. Co-Marketing Agreements**

The evidence showed that Tyco entered into co-marketing agreements with General Electric ("GE") and Hewlett Packard ("HP"), the largest original equipment manufacturers ("OEMs") of multi-parameter patient monitoring devices ("MPPMs"). MPPMs incorporate oximetry and measure a number of patient vital signs, in addition to blood oxygen levels. The co-marketing agreements provided that Tyco would license its oximetry technology for inclusion in MPPMs and pay GE and HP to market and promote Tyco sensors for use with Tyco compatible MPPMs. Tr. at 2179:8-2180:9; 2182:18-2183:9; 2188:15-2190:6. Masimo argued the agreements expressly required all MPPMs to be compatible with Tyco and, as a result, they were not compatible with Masimo. Masimo contends this result made the agreements de facto exclusive.

The evidence, however, showed that neither the GE or HP agreement included express terms requiring exclusive dealing with Tyco and both agreements were terminable at will on 90 days notice. Tr. at 2174:6-

11; 2176:21-2177:7. As discussed previously, even if an agreement is exclusionary, if it is terminable on short notice it is usually not anticompetitive because foreclosure is very unlikely. *See Western Parcel Express*, 190 F.3d at 976. As with the Sole Source agreements previously discussed, there was no evidence that co-marketing agreements directly restrained hospitals.

In addition, there was substantial evidence that the co-marketing agreements did not foreclose competition and that the OEMs could and did market more than just Tyco oximetry. GE offered Datex-Ohmeda oximetry, as well its own technology. In 1999, over a year before the expiration of the Tyco/GE co-marketing agreement, GE began marketing Masimo technology. Tr. 2178:16-2179:3, 2190:20-2191:5; Tr. 699:16-700:18, 1873:12-25, 2190:14-19, 2191:6-16; 823:22-824:1, 2190:14-19. Similarly, HP offered its own competing oximetry technology and sensors throughout the term of HP's co-marketing agreement with Tyco. Tr. at 2177:8-18. Accordingly, a reasonable jury could not conclude the co-marketing agreements were exclusionary or that they substantially foreclosed competition.

## II. SECTION 2 LIABILITY

Section 2 of the Sherman Act prohibits monopolies, attempts to form monopolies, and combinations and conspiracies to do so. 15 U.S.C. § 2. To establish a violation of Section 2, a plaintiff must show that (1) the defendant possessed monopoly power in the relevant market and (2) the defendant willfully acquired or maintained that power through "anticompetitive conduct," as opposed to gaining that power as a "consequence of a superior product, business acumen, or historical accident." *Image Tech. Serv., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1202, 1208 (9th Cir. 1997).

The possession of monopoly power in and of itself does not amount to a Section 2 violation; the monopoly power must be maintained unlawfully. *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, L.L.P.*, 124 S.Ct. 872, 879 (2004).

**A. Monopoly Power**

Monopoly power is defined as the "power to control prices or exclude competition." *Image Tech. Serv., Inc.*, 125 F.3d at 1202 (quoting *United States v. Grinnel Corp.*, 384 U.S. 563, 570-71 (1966)); *see also United States v. Syufy Enters.*, 903 F.2d 659, 664 (9th Cir. 1990). Market power can be proved by either direct evidence of the "injurious exercise of market power" or through circumstantial evidence. *Image Tech. Serv., Inc.*, 125 F.3d at 1208. When proving monopoly power by circumstantial evidence, the plaintiff must establish more than just market share; the plaintiff must: "(1) define the relevant market, (2) show that the defendant owns a dominant share of that market, and (3) show that there are significant barriers to entry and . . . that existing competitors lack the capacity to increase their output in the short run." *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir. 1995). A rebuttable presumption of market power arises where the defendant has 65% or more of the relevant market. *See Image Technical Serv., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1206 (9th Cir. 1997).

Based on the evidence at trial, a jury could reasonably have concluded Tyco had market power in the pulse oximetry systems market. Professor Elhauge testified that Tyco's market share based on revenue, ranged from 75% to 91% during the relevant time period. Tr. at 1163. Dr. Leitzinger offered similar testimony (Tr. at 1678) and internal Tyco documents suggested at least someone at Tyco believed its market share was in excess of 65%. *See, e.g.* JTX-686 (78% "total market share"); JTX-88 (89% "national market share" in oximetry as of 9/29/1999). Dr. Willig testified for Tyco that Tyco's market share was 60.9% in 2002. Tr. At 2577:12-2579:3. His testimony, though raising questions about the reliability of Leitzinger's market share analysis, only presented data for 2002 and did not specifically challenge market share numbers prior to July 2001. The jury was free to infer that because Willig only introduced a market share number for 2002, even if his method of analysis was applied to the pre-July 2001 periods, Tyco's market share would have exceeded 65%. Additionally, Masimo introduced evidence that Tyco was able to maintain high gross profit margins in the face of competition and that there were significant barriers to entry in the pulse oximetry market. Tr. 1163-71, 1665-66, 1678-84. A reasonable jury could therefore have concluded Tyco had market share in excess of 65% and that Tyco failed to rebut the presumption that it had market power.

**B. Wrongful Maintenance of Monopoly Power**

The second element of a Section 2 monopoly claim, referred to as the "conduct" element, addresses the question of whether Tyco used its "monopoly power to foreclose competition, to gain a competitive advantage, or to destroy a competitor." *Image Tech. Serv., Inc.*, 125 F.3d at 1208 (internal quotations omitted). To prove a Section 2 violation, the plaintiff must show that the defendant "willfully acquired or maintained [monopoly] power" through anticompetitive acts. *City of Anaheim v. Southern Cal. Edison Co.*, 955 F.2d 1373, 1376 (9th Cir. 1992). A jury could reasonably have determined that the Market Share Discounts and Sole Source contracts discussed in the previous sections were designed to and did maintain monopoly power. Therefore, the jury's verdict, with respect to Section 2 liability, is sustained.

As noted earlier, insufficient evidence was presented to the jury to permit it to reach any reasonable conclusion about the anticompetitive effect of Tyco's bundling practices. The bundling programs varied widely in terms of the number and types of products included, as well as in the amount of the discounts that were offered. The bundling programs were dealt with so imprecisely at trial that a jury could not reasonably conclude how much, if any, of the bundled oximetry sales were sold in connection with anticompetitive bundling practices as compared to legitimate bundling practices. For that reason, Tyco's bundling practices do not form an independent basis for Section 2 liability.

Additionally, during the course of the trial and the preparation of this memorandum, the court has had the opportunity to reconsider Masimo's bundling claims and the practice of bundling in general within the context of Section 2. In support of its bundling claims, Masimo relied primarily on the *LePage's* and *SmithKline* decisions previously cited. The *LePage's* and *SmithKline* decisions held bundled rebates violated Section 2 when the bundled discounts "linked a product on which [the Defendant] faced competition with products on which it faced no competition." *LePage's* at 156 (citing *SmithKline* at 1065). This court allowed Masimo's Section 2 bundling claim to proceed to trial based on the reasoning of the *LePage's* case and Masimo's assertion that "Tyco introduced bundled discount programs that sought to *leverage Tyco's dominant position in [non-oximetry] products* with its dominant position in pulse oximetry." Masimo Summary Judgment Opp. at 10-11. (Emphasis added). At trial Masimo failed to demonstrate that Tyco did not face competition in the non-oximetry products it included in some bundles. According to *LePage's* and *SmithKline*, it is only when products that do not face competition are included in a bundle that the bundle can conceivably be anticompetitive.

In *SmithKline*, defendant Eli Lilly offered bundled discounts for the purchase of three different cephalosporin antibiotics. Eli Lilly had patents on two of the antibiotics and according to the trial court, Eli Lilly had monopoly power with respect to both of them. In *LePage's*, defendant 3M offered bundled discounts for generic transparent tape, bundled with a variety of other products, including 3M's Scotch-brand tape. The *LePage's* court found that Scotch-brand tape was indispensable to retailers in the transparent tape market and as such Scotch-brand tape was essentially like a monopoly. *LePage's* at 156. The *LePage's* court concluded:

> 3M bundled its rebates for Scotch-brand tape with other products it sold in much the same way that Lilly bundled its rebates for [its three antibiotics]. In both cases, *the bundled rebates reflected an exploitation of the sellers monopoly power.* Just as "[cephalosporins] [were] carried in . . . virtually every general hospital in the country," *SmithKline*, 575 F.2d at 1062, the evidence in this case shows that Scotch-brand tape is indispensable to any retailer in the transparent tape market.

*Id.* (Emphasis added). The court then held that 3M's conduct, like Lilly's before it, was anticompetitive because 3M leveraged Scotch-brand tape (a monopoly) against captive purchasers of Scotch tape to create a new monopoly in generic transparent tape. *Id.*

Based on *LePage's* and *SmithKline*, Masimo would have had to have shown at a minimum: (1) that Tyco had monopoly or near monopoly power in at least one non-oximetry product included within its bundles (i.e. that such product faced no competition), and (2) that Tyco used that monopoly power as leverage in maintaining its monopoly in the relevant market. Insufficient evidence was presented for a jury to conclude that either requirement was met. Therefore, even if this court were to continue to be persuaded by the reasoning of *LePage's* and *SmithKline*, Tyco's bundling practices would not have violated Section 2.

Upon careful consideration, this court disagrees with the reasoning of the *LePage's* and *SmithKline* opinions. The court concludes that as a general matter, absent evidence of predatory pricing or tying, the practice of offering a discount on two or more bundled products is not anticompetitive under Section 2. There may be factual circumstances that warrant consideration of the antitrust implications of bundling practices, separate and apart from predatory pricing and tying, but those circumstances are not present in this case or, in the court's opinion, in the factual record presented in the *LePage's* and *SmithKline* opinions.

**III. DAMAGES**

As previously discussed, the jury's Section 1 and 3 liability verdict is sustained based only on the anticompetitive effects of the Market Share Discounts and Sole Source contracts. For that reason the damages the jury apportioned to the other alleged anticompetitive practices cannot be sustained. Accordingly, the damages awards of $13 million related to Product Bundling and $13 million related to Co-Marketing Agreements are vacated. Because the jury did not award damages for the Section 2 claim, the only damages issues that remain for the court to review are the awards of $57 million related to Market Share Discounts and $57 million related to the Sole Source contracts.

Dr. Leitzinger, Masimo's damages expert, calculated Masimo suffered $97.41 million in damages prior to July 2001 as a result of all of the allegedly anticompetitive practices. Tr. at 3263:24-3264:3. The damages figure was reached using a "yardstick" methodology which purported to measure the relative performance of Tyco and Masimo in an isolated portion of the oximetry market that was not subject to the alleged anticompetitive practices. From that data or "yardstick" measure, the expert extrapolated what Masimo's profits would have been in the whole market absent the alleged anticompetitive practices. Tr. 1812.

Leitzinger used oximetry monitor sales made to defibrillator manufacturers as his "yardstick" . Id. He calculated that Masimo's market share in this segment of the overall market averaged 50.2% over its first four years. Tr. at 439-40, 1804-06; Demo-118. Based on this information, he calculated his damages figure for the entire oximetry market. He concluded that absent Tyco's alleged anticompetitive practices Masimo would have sold 8% of all new oximetry monitors in 1998 (its first year of sales), 25% in 1999 and 50% in 2000 and 2001. Tr. 1806-07; Demo-119.

Dr. Leitzinger's analysis, however, ignored some critical problems with using the defibrillator market as a bench mark for comparison. The defibrillator market accounted for a very small percentage of the overall oximetry market, approximately 4% in 2002. Id. The fact that Masimo was able to quickly attain 50% market share in 4% of the market, does not necessarily imply that it would have achieved commensurate success in the remaining 96% of a $150 million market. Leitzinger's methodology did not account for differences in the competitiveness and complexity of the overall market and the defibrillator segment.

Masimo sold oximetry for inclusion in defibrillators primarily to Zoll Medical Corporation, one of the two dominant defibrillator manufacturers. In 1998, and particularly in 1999, Zoll achieved breakthrough innovations in defibrillator technology that dramatically increased sales. By virtue of its association with Zoll, Masimo's market share in that segment also increased. As Dr. Ordover testified, although Masimo's technology may have been a benefit to Zoll, it was Zoll's technological advances that substantially increased Masimo's market share. By applying Masimo's Zoll-assisted market share to the overall market, Leitzinger inflated the success Masimo would have had on its own in the overall market.

Despite the analytical shortcomings of Leitzinger's damage model, the jury awarded Masimo $140 million, over $40 million more than Leitzinger's pre-July 2001 damages figure of $97.41 million. Masimo contends the jury was free to conclude Leitzinger's estimates were unduly conservative. Opp. at 43. For the reasons previously discussed, the court disagrees and finds that even if the jury's liability findings had survived in their entirety, the award would not have fallen "within the range sustainable by the proof." *United States v. Sullivan*, 1 F.3d 1191, 1196 (11th Cir. 1993). The court, therefore, cannot sustain the damages awards associated with the Market Share Discounts and Sole Source contracts because they were derived from the larger unsustainable damages figure and the court does not find them independently supportable.

Leitzinger's method of apportioning damages among the various practices appeared to the court to be without basis. In fact at one point in the trial he indicated there was "no way" for him to determine the damages caused by an individual practice. Tr. at 3074:10-3075:3. It is clear that in many cases the evidence of Market Share Discounts and Sole Source GPO contracts involved the same conduct at the same hospitals. Leitzinger's method of allocation did nothing to separate the substantial overlap of conduct and this led to what appears to have been a substantial duplication of damages.

Additionally, Leitzinger's allocation of damages to Sole Source contracts was premised on his opinion that Sole Source contracts affected 70% of the market. This conclusion was wholly unsubstantiated by the evidence. To take one example, Leitzinger included the Novation Sole Source GPO agreements in reaching his 70% figure. As was discussed, the inclusion of these agreements to the same extent as Premier and Consorta created significant errors.

For the foregoing reasons, the court finds the damages awards of $57 million related to Market Share Discounts and $57 million related the Sole Source contracts do not "lie within the range sustainable by the proof." *Los Angeles Memorial Coliseum Comm'n v. Nat'l Football League*, 791 F.2d 1356, 1366 (9th Cir. 1986). The damages "verdict is contrary to the clear weight of the evidence," and enforcing it would be "a miscarriage of justice." *Hangarter v. Provident Life & Accident Ins. Co.*, 373 F.3d 998, 1005 (9th Cir. 2004). Accordingly, the court grants Defendants' motion for a new trial on damages relating to the Market Share Discount agreements and Sole Source GPO contracts for the pre-July 2001 damages period.

**IV. THE MOTION FOR PERMANENT INJUNCTION**

The court's power to issue an injunction against threatened anticompetitive conduct stems from Section 16 of the Clayton Act, 15

U.S.C. § 26, which allows suits for injunctive relief "against threatened loss or damage by a violation of the antitrust laws." In demonstrating a threat of antitrust injury, the plaintiff must show that it is suffering or is likely to suffer the kind of injury that it would otherwise be entitled to relief for under antitrust law. *Cargill, Inc. V. Monfort of Colorado, Inc.*, 479 U.S. 104, 112, 107 S.Ct. 484, 93 L. Ed. 2d 427 (1986).

The court has sustained the jury's finding that Tyco violated Sections 1, 2, and 3 through the use of Sole Source contracts and, that Masimo suffered damages prior to July 2001. The record demonstrates that the practices employed by Tyco and the oximetry market in general have changed substantially since July 2001. By 2003, Masimo was on contract with Premier and Novation, the largest GPOs, dramatically altering the possibility of market foreclosure from Sole Source contracts.

The jury was not specifically asked to determine liability by time period. The jury however, allocated the entire damages award to the pre-July 2001 time period, necessarily finding that Nellcor's conduct did not cause Masimo injury post-July 2001. The court finds no evidence that Masimo is currently suffering, or is likely to suffer, antitrust injury from the Market Share Discounts or Sole Source contracts. Accordingly, the court is unlikely to find that the imposition of a permanent injunction is a necessary remedy. However, it will consider that matter at a later time.

**CONCLUSION**

The jury's Section 1, 2 and 3 liability verdict is sustained based on the anticompetitive effects of Market Share Discounts and Sole Source contracts. The jury's findings of liability based on the other alleged anticompetitive practices are vacated. The jury's damages award is vacated in its entirety. The court GRANTS Defendants' motion for a new trial on damages.

SCANNED

IT IS SO ORDERED

DATED: March 22, 2006

Mariana R. Pfaelzer

Honorable Mariana R. Pfaelzer
United States District Judge