No.

In the Supreme Court of the United States

MASIMO CORPORATION,
Petitioner,
v.
MICHAEL RUHE AND VICENTE CATALA,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This Court long ago observed that "we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review." *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149 (1968). Consistent with that concern, the rules governing arbitration—including the arbitration in this case—uniformly require that motions for disqualification should be referred to an independent decisionmaker. And to promote the federal interest in the integrity of the arbitration process, Congress has provided that an arbitration award should be vacated where there was "evident partiality." 9 U.S.C. § 10(a)(2).

In this case, petitioner moved to disqualify the arbitrator when it learned that the arbitrator's brother had served as lead counsel to petitioner's chief competitor in recent litigation against petitioner that resulted in "two high-stakes, high-profile, back-to-back losses" for the arbitrator's brother. App. 12a. In response, the arbitrator refused to refer petitioner's motion to a neutral decisionmaker, summarily rejected petitioner's motion, and imposed punitive damages against petitioner in an amount totaling sixteen times compensatory damages based on the filing of that disqualification motion and other litigation conduct.

The district court held that the arbitrator's award must be vacated because petitioner had presented "compelling evidence" of "evident partiality" in a detailed opinion that, among other things, found that the arbitrator had improperly "punished" petitioner for filing the disqualification motion. *Id.* at 19a-20a. The

Ninth Circuit summarily reversed, holding that the district court erred in finding "that the arbitrator exhibited 'evident partiality.'" *Id.* at 2a. Then the court went further by rejecting petitioner's alternative argument—not passed on by the district court—that the arbitrator's decision must be set aside because it reflects a "manifest disregard of the law" (*see* 9 U.S.C. § 10(a)(4)), by ruling that petitioner, as appellee, had waived the core of that alternative argument by not pressing it as an alternative ground to affirm.

The questions presented are:

1. Whether the Ninth Circuit properly concluded—in conflict with the decisions of other courts—that an arbitrator's refusal to refer a disqualification motion to a neutral decisionmaker, reliance on a party's disqualification motion as a basis for imposing punitive damages, or other circumstances like those presented here does not establish "evident partiality."

2. Whether the Ninth Circuit properly held—in conflict with the decisions of other courts—that an appellee waives an argument pressed in, but not passed on by, the district court by not advancing it as an alternative ground for affirming the judgment below.

RULE 29.6 STATEMENT

Masimo Corporation is a publicly held corporation. BlackRock, Inc., is a publicly held corporation that owns 10% or more of Masimo Corporation's stock.

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PETITION FOR A WRIT OF CERTIORARI

Masimo Corporation (Masimo) respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit (App. 1a-5a) is available at 2016 WL 685115. The order of the district court granting Masimo's motion to vacate the arbitration award (App. 6a-23a) is available at 14 F. Supp. 3d 1342.

JURISDICTION

The Court of Appeals entered judgment on February 19, 2016. App. 1a-3a. This Court has jurisdiction under 28 U.S.C. § 1331.

CONSTITUTIONAL AND STATUTORY PROVISION INVOLVED

The Due Process Clause of the Fourteenth Amendment provides in part that no State shall "deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1. The Federal Arbitration Act (FAA), 9 U.S.C. § 10, is reproduced at App. 101a.

INTRODUCTION

This case concerns the statutory protection for ensuring the integrity of the arbitration process, an increasingly important form of dispute resolution in this country. This Court has observed that "we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate

review." *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145, 149 (1968). And Congress has similarly provided that a court should vacate any arbitration award that is tainted by "evident partiality." 9 U.S.C. § 10(a)(2).

The district court vacated the $5.4 million arbitration award in this case after finding that Masimo had presented "compelling evidence" of "evident partiality" on the arbitrator's part. App. 17a-18a. Masimo's challenge was based on its discovery that the arbitrator's brother had represented one of Masimo's competitors in recent litigation. But it was not just any litigation—it involved "two high-stakes, high-profile" cases in which Masimo was awarded more than a half-billion dollars in damages from the arbitrator's brother's client. *Id.* at 18a. And it was not just any competitor—it was Masimo's chief rival, akin to a "Coke and Pepsi" situation. *Id.* at 17a.

These circumstances were "serious" enough. *Id.* But the arbitrator's handling of Masimo's challenge set off more alarm bells. First, even though every arbitrator has a direct financial interest in his continued service on a case—the arbitrator had been paid over a million dollars in this case—and even though the rules governing the arbitration thus require an arbitrator to refer any disqualification request to a neutral decisionmaker, the arbitrator simply decided Masimo's challenge himself. *Id.* at 18a. And second, the arbitrator "used the very fact that Masimo's counsel made the challenge as a basis for imposing punitive damages against Masimo," "punish[ing] Masimo for making the challenge." *Id.* at 18a-19a.

In a thorough and thoughtful opinion, the district court held that the arbitrator's conduct undermined the

"integrity of the process" and required vacatur of the arbitrator's award under the Federal Arbitration Act (FAA) for "evident partiality." *Id.* at 18a. The Ninth Circuit summarily reversed, categorically rejecting the district court's finding of "evident partiality." *Id.* at 1a-3a. The Ninth Circuit's ruling is at odds with this Court's decision in *Commonwealth Coatings*, exacerbates widespread confusion among the lower courts, effectively guts the FAA's "evident partiality" provision, and warrants this Court's review.

This case also presents a second issue that warrants this Court's review. After the Ninth Circuit rejected the district court's "evident partiality" ruling, the court proceeded to reject Masimo's alternative argument—not reached by the district court below—that the arbitration award should be vacated for "manifest disregard of the law." *Id.* at 2a-3a. In rejecting that alternative argument, the Ninth Circuit held that Masimo had "waived" the crux of the argument by failing to challenge the constitutionality of the punitive damages award on appeal. *Id.* at 2a-3a & n.1. That waiver ruling directly conflicts with the decisions of other circuits, which sensibly hold that an appellee does *not* waive the opportunity to press an alternative argument on remand by failing to make it in defense of the judgment on appeal.

The petition for certiorari should be granted.

STATEMENT OF THE CASE

A. Factual Background

Masimo is a ground-breaking medical-device manufacturer, founded in 1989 to solve "unsolvable" problems in the medical-device industry. SER2006-

07.[1] The company develops, manufactures, and sells noninvasive patient-monitoring devices, including revolutionary devices known as "pulse oximeters." App. 7a. These noninvasive devices lightly attach to the end of a patient's finger and measure certain characteristics of the patient's blood, such as oxygen saturation, by analyzing wavelengths of light as it passes through the patient's finger, instead of requiring a blood sample to be drawn and analyzed in a laboratory. *Id.* They are used in operating rooms and other critical care areas across the country today.

Over the past three decades, from its founding in company president Joe Kiani's garage, Masimo has seen tremendous growth and success. The company now defines the standard of care for pulse oximetry. Its pulse oximeters are used in eight of the top ten hospitals in the country. SER2006-07. And it has received numerous industry awards for its revolutionary products and technologies. SER2008-09.

Respondents Michael Ruhe and Vincente Catala joined Masimo in 2008 and 2009, respectively, as sales representatives for Masimo's newest line of devices—the Pronto and Pronto-7. App. 8a. These devices use Masimo's pulse-oximetry technology to measure the total hemoglobin concentration in a patient's blood, in addition to oxygen saturation and other characteristics. *Id.* at 7a-8a. The Pronto devices were the first on the market to allow doctors to measure total hemoglobin without drawing blood. SER2007. They were cleared by the FDA for sale in 2008 and 2010, *id.*, and have earned Masimo several more awards for innovation in

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[1] ER refers to the Excerpts of Record and SER refers to Supplemental Excerpts of Record filed in the Ninth Circuit.

medicine, including the 2010 American Business Award for Best New Product or Service in Health and Pharmaceuticals and the 2011 iF Product Design Award in medicine and healthcare. SER2008-09.

Ruhe and Catala began selling the Pronto devices as part of a "limited market release" to select customers willing to test new technology and provide feedback. SER1035-36; *see* SER1020. By mid-2010, however, their sales "had fallen off drastically." App. 8a, 47a. In October 2010, Ruhe told his supervisor that he was "losing faith" in Masimo's technology. SER1004-05. Masimo offered to set up additional clinical testing to address his concerns. SER1005. Initially, Ruhe indicated he thought the additional testing was a good idea, and that he would give it some thought. *Id.* But both respondents delivered their resignation letters the next day, citing concerns about the accuracy of the Pronto devices. *Id.*; App. 48a.

Masimo promptly notified the FDA of respondents' concerns and granted the agency "unfettered access to all its activities and documents, including marketing materials, technical bulletins, and customers complaints." *United States ex rel. Ruhe v. Masimo Corp.*, 977 F. Supp. 2d 981, 988-89 (C.D. Cal. 2013). The FDA launched a thorough, unannounced investigation into the matter and declined to take any enforcement action, finding no areas of concern. *Id.* at 989.

B. *Qui Tam* Action

One week after resigning, Ruhe and Catala filed a *qui tam* complaint against Masimo, asserting claims under the False Claims Act based on allegations that Masimo had made misrepresentations to the FDA and medical providers concerning, among other things, the

accuracy of the Pronto devices. *See id.* at 984. The United States chose not to intervene. *Id.* at 989.

The district court granted summary judgment to Masimo, finding "no evidence" that Masimo had misled the FDA or medical providers in connection with the clearance, marketing, or sale of the Pronto devices, and "overwhelming evidence" of Masimo's "good faith belief in the medical value of the Pronto Devices as well as their value to members of the medical community." *Id.* at 984, 992-95, 996. Indeed, the court noted that "[m]ultiple clinical studies conducted by independent researchers have . . . found [the Pronto devices] to perform comparable to or better than alternative point-of-care hemoglobin measurement devices," "Masimo has received numerous awards for innovation and product design for the Pronto-7," and of all instances in which a potential purchaser decided not to purchase a Pronto device, "only 4% were due to concerns about accuracy." *Id.* at 995. The Ninth Circuit affirmed. 2016 WL 684608, at *1 (9th Cir. Feb. 19, 2016).

C. Arbitration Proceedings

Seven months after filing the *qui tam* complaint, while the case was still pending before the district court, Ruhe and Catala filed this action, asserting claims against Masimo for wrongful constructive discharge in violation of various state and federal laws. App. 9a-10a. Because respondents had agreed to arbitrate any disputes arising from their employment with Masimo through Judicial Arbitration and Mediation Services (JAMS), the district court referred the dispute to arbitration. *Id.* at 10a.

The parties chose Richard C. Neal, a retired justice of the California Court of Appeal, as arbitrator. ER109. The case proceeded through discovery to a hearing, with closing arguments in July 2013. ER107.

In October 2013, while the parties awaited the arbitrator's decision, the district court awarded Masimo summary judgment in the *qui tam* suit—involving the same parties and many of the same issues pending before the arbitrator, including Masimo's good-faith belief in the accuracy of the Pronto devices. *See United States ex rel. Ruhe*, 977 F. Supp. 2d at 981, 995. Masimo requested leave to brief the collateral-estoppel effect of the district court's decision. App. 11a. The arbitrator indicated that he was "not happy" about the delay, but agreed to additional briefing. *Id.*

1. The Arbitrator's Liability Finding

One week after briefing, the arbitrator issued an Interim Award in favor of respondents. While admitting the "factual overlap" with the *qui tam* case, he refused to give collateral-estoppel effect to the district court's findings in that case. ER646-50. Then, in direct conflict with the district court's findings, the arbitrator found that Masimo had pressured Ruhe and Catala to sell medical devices that it knew were "faulty and did not perform as claimed." ER654-55. On that basis, the arbitrator found in favor of respondents on their wrongful constructive discharge claims. *Id.* Then, with respect to damages, the arbitrator concluded that respondents not only were entitled to economic and general damages, but had proven conduct sufficient to justify an award of punitive damages. ER662-63. He ordered additional briefing on the appropriate amount of punitive damages. ER663.

2. Masimo's Disqualification Request

Shortly before the scheduled hearing on punitive damages, Masimo learned that the arbitrator's brother was Stephen Neal, a litigation partner at the law firm Cooley LLP. Neal had represented Masimo's chief competitor Nellcor Puritan Bennett, Inc., in two high-profile, high-stakes cases against Masimo, and lost—big—both times. App. 12a. After a six-week trial in the first case, a jury awarded Masimo $164 million in damages for Nellcor's infringement of several of Masimo's patents. *Id.* The second matter involved a four-week jury trial that resulted in a staggering $420 million damages award against Nellcor for antitrust violations. *Id.* It was the fifth-largest jury verdict of the year in California, *id.*, and Neal himself had served as lead counsel during the trial, ER610.

Masimo of course knew about the prior litigation against its chief rival, but did not know that the two Neals were brothers. Within 24 hours of making that startling discovery, Masimo sent a letter to the arbitrator and to the Executive Vice President and General Counsel of JAMS, John Welsh, advising them of the conflict. *See* ER610-11. In the letter, Masimo detailed its recent discovery and challenged the continued service of Stephen Neal's brother as arbitrator of this dispute. *See* ER611.

JAMS Rule 15(i), which governed the arbitration proceeding, provides that, "[a]t any time during the Arbitration process, a Party may challenge the continued service of an Arbitrator for cause," based on information that has become available to it. App. 102a. The challenge "must be in writing and exchanged with opposing Parties"—as Masimo's was—and the opposing party is entitled to a week to file a response.

Id. The rule then states that "JAMS shall make the final determination as to such challenge." *Id.*

The arbitrator, however, declined to refer Masimo's challenge to JAMS. Instead, he summarily denied the request himself the very next day. In a one-page order, the arbitrator proclaimed that he was unaware of his brother's role as lead counsel in the prior litigation and that, even if he had known of it, his brother's paid relationship with Masimo's arch rival in bet-the-company litigation between them was not enough "to cause a person to reasonably doubt [the arbitrator's] ability to be impartial in this case." ER609.

3. Punitive Damages Award

The punitive damages award hearing took place, as scheduled, the very next day. App. 11a. Five days later, the arbitrator issued his Final Award. *Id.* at 13a. The award confirmed the liability findings in his prior decision and awarded Ruhe and Catala $162,000 and $147,000, respectively, in compensatory damages for lost wages and claimed distress of dealing with unhappy customers, selling devices they believed were flawed, and entering the job market during a recession. *Id.* at 99a. But then the arbitrator went further and awarded Ruhe and Catala an additional $2.5 million each—sixteen times the amount of compensatory damages—in punitive damages as well. *Id.*

The arbitrator had already found that Masimo had generally treated Ruhe and Catala well. *Id.* at 77a. So he considered the alleged harm to third-parties—namely, other sales persons as well as doctors, patients, and clinics who purportedly were misled by Masimo about the devices—even while acknowledging the lack

of evidence of any actual harm to such third parties. *See id.* at 93a (reasoning that the "widespread *potential* harm to doctors, patients, clinics, and hospitals . . . is highly relevant," while suggesting that "only limited actual harm resulted" (emphasis added)).

In imposing punitive damages, the arbitrator also specifically relied on Masimo's litigation conduct, which he described as "abusive." *Id.* at 84a (citing *CGB Occupational Therapy, Inc. v. RHA Health Servs., Inc.*, 499 F.3d 184, 193-95 (3d Cir. 2007)). In particular, the arbitrator cited Masimo's request that the arbitrator withdraw from the arbitration due to a conflict, its assertion that due process limited the arbitrator's consideration of potential harm to third parties in determining the appropriate amount of punitive damages, and its reliance on the district court's findings in the *qui tam* action. *Id.* at 86a.

D. The District Court's Decision

Masimo moved to vacate the arbitrator's Final Award under the FAA. Masimo explained that the arbitrator's handling of its disqualification request established "evident partiality." Masimo's Br. in Supp. of its Mot. to Vacate Final Arbitration Award & Dismiss Action at 21-24, C.D. Cal. ECF No. 52 (Masimo Mot. to Vacate). In addition, Masimo argued that the award must be set aside for "manifest disregard of law," pointing in particular to the punitive damages award. *Id.* at 10-19. As Masimo explained, not only did the arbitrator clearly err under California law in basing punitive damages on litigation conduct, but his imposition of punitive damages in a 16-to-1 ratio to compensatory damages flagrantly contravened the constitutional limits set by this Court. *Id.* at 16-19.

The district court held that Masimo had established "evident partiality" on the arbitrator's part and thus vacated his award. App. 23a. The court recognized that Congress enacted the FAA to "encourage the expeditious resolution of disputes through arbitration," but Congress did not "authorize litigants to submit their cases and controversies [to arbitrators who] might reasonably be thought biased against one litigant and favorable to another." *Id.* at 16a (alteration in original) (citation omitted). Where a party challenging an award proves facts "which would establish a reasonable impression of partiality," the court held an arbitration award must be vacated. *Id.* (citing 9 U.S.C. § 10(a)(2)). "Unfortunately, this case is one of those rare occasions." *Id.* at 23a.

The district court found that Masimo had "properly raised the challenge to the Arbitrator's partiality," but that the arbitrator had "disregarded the procedures set in place by his own organization and unilaterally determined that there was no cause for his disqualification." *Id.* at 17a. JAMS Rule 15(i) "is not a mere formality," the court stated, but rather "reflects the wise policy that the final determination on challenges of bias should not be made by the presiding officer who is alleged to be biased." *Id.* "The integrity of the process," the court continued, "required that the challenge be referred to JAMS for determination in accordance with JAMS's rules, under which the parties had agreed to arbitrate." *Id.* at 18a.

The arbitrator's "dismissive" treatment of Masimo's disqualification request also raised a red flag. *Id.* at 17a. As the district court explained, while the arbitrator treated the motion as being based "merely . . . on the fact that his brother 'represented companies

adverse to Masimo in litigation,'" "[t]he circumstances in reality were much more serious." *Id.* (quoting *id.* at 27a). "In the lucrative market for pulse oximetry medical devices, Masimo and Nellcor were Coke and Pepsi." *Id.* And the matters that the arbitrator's brother handled were not ordinary cases, they were "two high-stakes, high-profile litigation losses to Masimo," in which "Masimo was awarded over a half billion dollars in damages and won a permanent injunction under which Nellcor had to stop selling its current line of pulse oximeters." *Id.* at 18a.

Moreover, the court continued, "this was not all the Arbitrator did"—"[h]e used the very fact that Masimo's counsel made the challenge as a basis for imposing punitive damages against Masimo, further demonstrating evident partiality." *Id.* The court explained, however, that it is clear under California law that "a defendant's trial tactics and litigation conduct may not be used to impose punitive damages in a tort action." *Id.* at 18a-19a (citation omitted). Moreover, as the court continued, Masimo's counsel's arguments seeking recusal were reasonable and consistent with their ethical duty "to zealously advocate on behalf of his client." *Id.* at 22a. The court held that the imposition of punitive damages based on Masimo's counsel's "reasonably zealous advocacy" demonstrated "clear partiality" on the arbitrator's part and "undermined the integrity of the award and the entire proceedings." *Id.* at 19a, 22a-23a (citation omitted).

Because the district court vacated the arbitration award based on the arbitrator's "evident partiality," it did not reach Masimo's alternative argument that he also acted in "manifest disregard of law."

E. The Ninth Circuit's Decision

Less than three weeks after the case was argued, the Ninth Circuit issued an unpublished, per curiam decision summarily reversing the district court. *Id.* at 1a-5a. The panel held that the district court "erred in holding that the arbitrator exhibited 'evident partiality.'" *Id.* at 2a. In so holding, the panel did not even mention the arbitrator's failure to refer Masimo's disqualification motion to a neutral decisionmaker. Instead, the panel explained that, in its view, the fact that the arbitrator's brother had personally litigated major cases against Masimo on behalf of an arch rival provided no reason to "doubt [his] impartiality." *Id.* (citation omitted). The panel further held that the fact that the arbitrator based punitive damages on Masimo's litigation conduct—including Masimo's motion to disqualify—did not show evident partiality, because that did not amount to "'affirmative misconduct' or 'irrational[ity].'" *Id.* (alteration in original) (citation omitted).

The panel then rejected the alternative challenges to the arbitration award that Masimo had advanced in the district court—but which the district court did not address. Although Masimo had expressly reserved its "manifest disregard of the law" argument in its appellate brief, the panel held that the arbitrator's ruling did not "rise to the level of manifest disregard of the law." *Id.* at 3a. In reaching that conclusion, however, the panel refused to consider the crux of Masimo's "manifest disregard" argument: its claim that "the punitive damages award—sixteen times the compensatory damages award—raises due process concerns." *Id.* at 2a n.1. Instead, the panel held that this issue "was waived" because "neither party raised

this issue on appeal." *Id.* Accordingly, the panel ordered the district court "to issue an order confirming the arbitration award in its entirety." *Id.* at 3a.

Judge Hurwitz filed a concurring opinion stating that he was "troubled by this case." *Id.* at 4a. In contrast with the panel opinion, he acknowledged that "an arbitrator should not himself determine whether he should be recused, given his financial interest in continued employment." *Id.* In addition, he admitted that the punitive damages award "concern[ed]" him, explaining that the arbitrator not only had incorrectly based the award "on the conduct of Masimo's attorneys during arbitration," but also that the amount of the award "raises obvious due process concerns." *Id.* Nevertheless, Judge Hurwitz reasoned that even these errors did not "mandate vacation of the award." *Id.*

REASONS FOR GRANTING THE WRIT

This Court has frequently emphasized the federal policy in favor of arbitration where parties agree to it, as expressed in the FAA. But regardless of one's views on the benefits—or shortcomings—of arbitration, all should agree on the importance of ensuring the integrity of the arbitration process.

This Court certainly has. Nearly a half century ago, this Court admonished that "safeguard[ing] the impartiality of arbitrators" was, if anything, more important than ensuring the impartiality of judges, given the nearly unreviewable power arbitrators have in deciding cases. *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. at 145, 149 (1968). And Congress has likewise acted to safeguard the integrity of the arbitration process by providing for the vacatur

of any award tainted by "evident partiality." 9 U.S.C. § 10(a)(2).

Yet, in the absence of any guidance from this Court in the nearly half century since *Commonwealth Coatings* was decided, conflict and confusion has developed in the lower courts over the scope of this critical safeguard. The Ninth Circuit's decision in this case not only exacerbates that confusion, but conflicts with *Commonwealth Coatings* and effectively guts the "evident partiality" provision.

The Ninth Circuit's extraordinary waiver ruling also warrants this Court's review. Numerous other circuits have held that an appellee's decision not to raise a potential alternative ground for affirmance does *not* waive that party's ability to pursue the alternative ground on remand. That rule makes perfect sense as a matter of fairness and sound appellate practice. The Ninth Circuit's decision to the contrary will ambush appellees like Masimo who defend the district court's reasoning on appeal and force appellees to bombard the courts of appeals with argument on extraneous issues that the district courts did not pass on below.

This Court's intervention is needed.

I. THE NINTH CIRCUIT'S "EVIDENT PARTIALITY" RULING WARRANTS THIS COURT'S REVIEW

In *Commonwealth Coatings*, this Court stressed that the "broad statutory language" in the FAA's "evident partiality" provision requires a court to vacate any arbitration award that is tainted by either actual or apparent bias. 393 U.S. at 148-49. But lower courts have divided over the proper interpretation of *Commonwealth Coatings* and widespread confusion

has developed in the lower courts on the proper application of the FAA's "evident partiality" provision. The Ninth Circuit's decision in this case renders this important safeguard all but meaningless and thus underscores the need for further guidance.

A. The Ninth Circuit's Decision Is Starkly At Odds With This Court's Opinion In *Commonwealth Coatings*

The last, and only, time this Court has elaborated on the scope of the "evident partiality" provision is in *Commonwealth Coatings*, decided nearly 50 years ago. 393 U.S. at 146-49. The case involved a dispute between a prime contractor and a subcontractor over money allegedly owed for a painting job. *Id.* at 146. The parties agreed to arbitrate the dispute, but unbeknownst (and undisclosed) to the subcontractor, one of the three arbitrators had served as an engineering consultant for the prime contractor sporadically over a period of four to five years, collecting close to $12,000 in fees during that time. *Id.* After the relationship came to light, the lower courts refused to set aside the award on the basis of "evident partiality." *Id.* at 147. This Court reversed. *Id.* at 150.

In his opinion for the Court, Justice Black framed the question as "whether elementary requirements of impartiality taken for granted in every judicial proceeding are suspended when the parties agree to resolve a dispute through arbitration." *Id.* at 145. He answered that question with a resounding "no." To the contrary, he explained, the FAA and its evident partiality ground for vacatur of an arbitration award "show a desire of Congress to provide not merely for *any* arbitration but for an impartial one." *Id.* at 147.

"[A]ny tribunal permitted by law to try cases and controversies not only must be unbiased but also avoid even the appearance of bias." *Id.* at 150. Under that standard, the Court had "no doubt" that if a juror or judge had shared a relationship with a litigant like the one between the arbitrator and this prime contractor, the "judgment would be subject to challenge." *Id.* at 148. Indeed, the Court explained, a judicial decision *must* be set aside "where there is 'the slightest pecuniary interest' on the part of the judge" in its outcome. *Id.* (quoting *Tumey v. Ohio*, 273 U.S. 510, 524 (1927)).

The Court saw no basis for refusing to find similar ground for vacating an arbitration award "in the broad statutory language that governs arbitration proceedings and provides that an award can be set aside on the basis of 'evident partiality.'" *Id.* Indeed, this Court went even further. Given the limited judicial review available for the merits of arbitration decisions, the Court observed that courts "should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges." *Id.* at 149.

In reaching that conclusion, the Court found "highly significant" the rule of the American Arbitration Association that required the disclosure of "any circumstances likely to create a presumption of bias or which [the arbitrator] believes might disqualify him as an impartial Arbitrator," *id.*, and the canon of judicial ethics that warned judges to avoid "such action as may reasonably tend to awaken the suspicion that his social or business relations or friendships constitute an element in influencing his judicial conduct," *id.* at 149-50 (citation omitted). Because the arbitrator's failure to disclose prior business ties with one of the parties in

arbitration created at least an appearance of bias, the Court held that the award must be vacated. *Id.*

The Ninth Circuit's decision in this case is fundamentally at odds with the Court's opinion in *Commonwealth Coatings*. This case involved one arbitrator, not three. And, if anything, the arbitrator's handling of Masimo's disqualification request in this case paints a far more troubling picture of partiality than the circumstances in *Commonwealth Coatings*. Yet, far from "scrupulous[ly]" (393 U.S. at 149) ensuring the impartiality of the arbitrator, the Ninth Circuit bluntly rejected the district court's thorough "evident partiality" ruling. Moreover, in rejecting Masimo's reliance on the fact that the arbitrator based his award of punitive damages on Masimo's disqualification request, the Ninth Circuit reasoned that this did not constitute "'affirmative misconduct' or 'irrational[ity].'" App. 2a (alteration in original) (citation omitted). Yet, *Commonwealth Coatings* holds that "the *appearance* of bias" is enough to establish "evident partiality." 393 U.S. at 150 (emphasis added).

The Ninth Circuit's decision takes a starkly different, and much more narrow, approach to the FAA's "evident partiality" safeguard than this Court's decision in *Commonwealth Coatings*. In particular, in requiring a showing of "'affirmative misconduct' or 'irrational[ity],'" App. 2a (alteration in original) (citation omitted), the Ninth Circuit's decision stands in sharp contrast to *Commonwealth Coatings*.

B. The Lower Courts Have Divided On The Meaning And Rule Of Decision In *Commonwealth Coatings*

Although the Court's opinion for six Justices in *Commonwealth Coatings* was emphatic on the importance of avoiding actual or apparent bias in arbitration proceedings, the lower courts have divided over the proper interpretation of *Commonwealth Coatings*. The source of confusion stems from Justice White's separate concurring opinion in the case, joined by Justice Marshall, which made some "additional remarks." 393 U.S. at 150 (White, J., concurring). Although he joined Justice "Black's opinion in this case," *id.*, Justice White's concurring opinion took a less forceful view of the need for courts to police the impartiality of the arbitration process, which some courts have read as contradicting the reasoning of the Court.

Justice White wrote that, in his view, the majority opinion did not hold that "arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed any judges." *Id.* And although he agreed that actual bias was not required to vacate an award under the FAA, *see id.* at 151 n.* (concurring in vacatur even though "the arbitrator in this case was entirely fair and impartial"), Justice White never explained what showing short of the majority's "appearance of bias" he believed the FAA would require.

Over time, confusion has developed in the Circuits regarding *Commonwealth Coatings*'s standard for "evident partiality." *See, e.g.*, *Freeman v. Pittsburgh Glass Works, LLC*, 709 F.3d 240, 251 (3d Cir. 2013) (noting "confusion" over the definition of evident partiality "stem[ming] from *Commonwealth*

Coatings"); *Positive Software Solutions, Inc. v. New Century Mortg. Corp.*, 476 F.3d 278, 281 (5th Cir.) ("Reasonable minds can agree that *Commonwealth Coatings* . . . is not pellucid."), *cert. denied*, 551 U.S. 1114 (2007); *Morelite Constr. Corp. v. New York City Dist. Council Carpenters Benefit Funds*, 748 F.2d 79, 82 (2d Cir. 1984) ("[T]he result of [*Commonwealth Coatings*] appears to be ongoing uncertainty."); *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 681 (7th Cir.) ("The only Supreme Court decision, *Commonwealth Coatings Corp.*, . . . provides little guidance . . . ."), *cert. denied*, 464 U.S. 1009 (1983).

And a circuit split on the rule of *Commonwealth Coatings* has developed. Some Circuits have held that Justice White's opinion, not Justice Black's, must be considered the controlling opinion for the Court, reasoning that Justice White's concurrence was necessary to the Court's decision. *See, e.g.*, *Freeman*, 709 F.3d at 252 (concluding that Justice Black's "discussion of appearances is nonbinding"); *Positive Software Solutions*, 476 F.3d at 282 ("Justice White's concurrence, pivotal to the judgment, is based on a narrower ground than Justice Black's opinion, and it becomes the Court's effective *ratio decendi*."); *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644 n.5 (6th Cir. 2005) ("[A] majority of the Court did not endorse the 'appearance of bias' standard set forth in the plurality opinion."). Other courts have held that Justice Black's opinion for the Court controls. *See, e.g.*, *Schmitz v. Zilveti*, 20 F.3d 1043, 1047 (9th Cir. 1994) ("Given Justice White's express adherence to the majority opinion in *Commonwealth Coatings*, it is clear that the majority opinion, including its 'appearance of bias' language, received at least five votes.").

As a result, the standard for "evident partiality"—a vital protection for the arbitration system—has eluded clear definition in the lower courts. *See, e.g.*, *Morelite Constr. Corp.*, 748 F.2d at 82 ("Exactly what constitutes 'evident partiality' by an arbitrator is a troublesome question."); *International Bhd. of Elec. Workers, Local Union No. 323 v. Coral Elec. Corp.*, 104 F.R.D. 88, 89 (S.D. Fla. 1985) ("'Evident partiality' . . . is an elusive concept . . . ."); Kathryn A. Windsor, *Defining Arbitrator Evident Partiality: The Catch-22 of Commercial Litigation Disputes*, 6 Seton Hall Cir. Rev. 191, 192 (2009) ("[T]he standards for what constitutes evident partiality are vague and oftentimes conflicting."); *compare, e.g.*, *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 329 (6th Cir. 1998) ("Th[e] standard requires a showing greater than an 'appearance of bias,' but less than 'actual bias.'" (citation omitted)), *with Schmitz*, 20 F.3d at 1047 ("'Reasonable impression of partiality[]' . . . is the best expression of the *Commonwealth Coatings* court's holding."), *with Merit Ins. Co.*, 714 F.2d at 681 ("[C]ircumstances must be powerfully suggestive of bias . . . ."). Further guidance is needed.

C. The Ninth Circuit's Decision Exacerbates The Confusion Over The "Evident Partiality" Standard

For several reasons, the Ninth Circuit's decision in this case underscores the need for intervention by this Court in order to clarify the standard established by *Commonwealth Coatings* for "evident partiality" and safeguard the integrity of the arbitration process.

1. An Arbitrator's Unilateral Rejection Of A Motion For Disqualification In Blatant Disregard Of Governing Rules Establishes "Evident Partiality"

First, by refusing to condemn the arbitrator's decision to decide the challenge to his own impartiality, the Ninth Circuit has essentially blessed it. But as even Judge Hurwitz recognized in his concurrence, "an arbitrator should not himself determine whether he should be recused." App. 4a. That rule is compelled in any arbitration by this Court's precedent. It is all the more clear when the governing rules of the arbitration specifically require it, as they did here.

In *Commonwealth Coatings*, this Court reasoned that an arbitrator should not preside over any proceeding where he has "the slightest pecuniary interest" in the outcome. 393 U.S. at 148 (citation omitted). But that is exactly what an arbitrator who decides a challenge to his own impartiality does. Unlike Article III Judges, arbitrators are paid *by the case*. If an arbitrator disqualifies himself, he will have cost himself a (potentially significant) paycheck—not to mention any reputational harm such a decision could cause. In this case, for example, if the arbitrator had granted Masimo's motion, he likely would have forfeited the more than one million dollars in fees he had already generated on the arbitration and at least forfeited any additional fees on the matter—giving him "'a direct, personal, substantial, pecuniary interest" in the outcome of that motion. *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 876 (2009) (citation omitted). That financial interest not only creates an obvious risk of bias but a due process problem as well. *Id.*

This conflict has not gone unnoticed. The Second Circuit, for example, has recognized that a "strong[] risk of unfairness exists ... where the arbitrator, acting alone, determines the validity of his own dismissal from a lucrative position." *Pitta v. Hotel Ass'n of N.Y. City, Inc.*, 806 F.2d 419, 424 (2d Cir. 1986). The Ninth Circuit, in this case, completely dismissed that "strong risk of unfairness," not even acknowledging arbitrator's refusal to refer the disqualification motion to a neutral decisionmaker.

The governing rules of arbitration recognize this conflict as well. In *Commonwealth Coatings*, the Court viewed the rules of established arbitration tribunals and organizations as "highly significant" in determining the proper standards of impartiality. 393 U.S. at 149. On this question, the arbitration rules are unanimous. In addition to JAMS, the rules of arbitration from the American Arbitration Association, the United Nations, and the International Court of Arbitration *all* require that motions for disqualification be referred to an independent decisionmaker.[2]

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2 *See* App. 102a (JAMS Rule 15(i)); American Arbitration Ass'n, Employment Arbitration Rules and Mediation Procedures Rule 16(b) (Nov. 1, 2009) ("[T]he AAA shall determine whether the arbitrator should be disqualified ..., which decision shall be conclusive."); International Chamber of Commerce, Rules of Arbitration, art. 14(3) (Jan. 1, 2012) ("The [International] Court [of Arbitration] shall decide ... on the merits of a [disqualification] challenge ...."); U.N. Commission on International Trade Laws, Arbitration Rules, art. 6(2), 12(1), 13(4) (2010) (requiring the "Secretary-General of the Permanent Court of Arbitration at The Hague," or other agreed-upon appointing authority, to decide challenges to the arbitrator's "impartiality or independence").

As the district court observed, and *Commonweath Coatings* recognized (393 U.S. at 149), such rules are not "mere formalit[ies]." App. 17a. Rather, they reflect "the wise policy that the final determination on challenges of bias should not be made by the presiding officer who is alleged to be biased." *Id.* The fact that the "[a]rbitrator disregarded the procedures set in place by his own organization and unilaterally determined that there was no cause for disqualification is compelling evidence of his partiality." *Id.*

Of course, judges typically rule on motions for their own disqualification. But unlike an arbitrator, if a judge recuses himself, his compensation and employment are unaffected. He is paid by the government, not the parties, and in the federal system his appointment is for life. In addition, judges are not paid *by the case*; they are paid by annual salary. Unlike arbitration, moreover, judicial proceedings often have several other protections against partiality—such as rigorous evidentiary rules, requirements of written decisions, and robust appellate review. That is why courts must be "more scrupulous" in protecting the impartiality of arbitrators than judges. *Commonwealth Coatings*, 393 U.S. at 149.

An arbitrator's failure to refer a motion for disqualification to a neutral decisionmaker inherently taints the integrity of the arbitration process and requires reversal. The Ninth Circuit fundamentally erred in brushing aside this obvious structural error.[3]

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[3] The Court need not decide whether *due process* requires vacatur of an arbitrator's award in these circumstances. It is sufficient to hold that an arbitrator's refusal to refer a motion for

2. An Arbitrator's Imposition Of Excessive Punitive Damages Based On Attorney Conduct Establishes "Evident Partiality"

The Ninth Circuit compounded its error by permitting a punitive damages award granted "*in retaliation* for the very fact that Masimo made the [disqualification] challenge." App. 16a-17a (emphasis added). Even putting to one side an arbitrator's refusal to refer a disqualification motion to a neutral decisionmaker and summary rejection of a serious challenge to his impartiality, his imposition of punitive damages based in part on the "very fact that [counsel] made the challenge" (App. 18a) clearly creates (at least) an appearance of bias under 9 U.S.C. § 10(a)(2).

As this Court has repeatedly recognized, punitive damages awards raise their own due process concerns. *See, e.g.*, *Philip Morris USA v. Williams*, 549 U.S. 346, 353 (2007); *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 417-18 (2003); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 562 (1996). Unless properly cabined, the power to levy such awards threatens to invite punishments that "reflect not an 'application of law' but 'a decisionmaker's caprice.'" *Williams*, 549 U.S. at 352 (citation omitted). Many jurisdictions, including California (whose law governed the arbitration here) forbid a court from basing punitive damages—in any part—on counsel's "litigation conduct." *De Anza Santa Cruz Mobile Estates Homeowners Ass'n v. De Anza Santa Cruz Mobile Estates*, 94 Cal. App. 4th 890, 918 (2001).

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disqualification (in which he has a direct pecuniary interest) to a neutral decisionmaker establishes "evident partiality."

These same concerns bear on the existence of "evident partiality" in arbitration. *See Honda Motor Co. v. Oberg*, 512 U.S. 415, 432 (1994) (expressing concern for the "potential that juries will use their [punitive damage] verdicts to express biases against big businesses"). Indeed, the Securities and Exchange Commission has argued that "evident partiality" is the most appropriate avenue for judicial review of punitive damages awards granted in arbitration. *See* Brief of the Securities and Exchange Commission, Amicus Curiae, at 7, *Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132 (6th Cir. 1996) (No. 95-5257) (arguing that "FAA review for 'evident partiality' directly addresses the due process concerns raised by the Supreme Court in *Honda*"). And it is difficult to imagine a better illustration of the way in which a punitive damages award may give rise to "evident partiality" concerns than the award entered here.

As even the panel admitted, the punitive damages award in this case raised "obvious due process concerns," given its 16-to-1 ratio to compensatory damages. App. 4a; *see* Oral Argument at 1:40-42 (stating that the amount of the punitive damages awarded in this case is unconstitutional "on its face"); *see also State Farm*, 538 U.S. at 425 ("[F]ew awards exceeding a single-digit ratio between punitive and compensatory damages . . . will satisfy due process.").

And it is not even necessary to *speculate* as to whether Masimo's disqualification request influenced that extraordinary punitive damages award that the arbitrator imposed. The arbitrator expressly based his award of punitive damages on Masimo's litigation conduct—including the fact that Masimo had sought his removal based on the conflict it discovered. As the

district court found, such retaliatory conduct—an attempt to "punish" Masimo "for making the challenge"—displayed "clear partiality on his part." App. 19a. Yet the Ninth Circuit brushed that aside.

Contrary to the Ninth Circuit's reasoning, the district court was not required to find that basing punitive damages on Masimo's disqualification motion amounted to "'affirmative misconduct' or 'irrational[ity].'" *Id.* at 2a (alteration in original) (citation omitted). The "broad statutory language" of the FAA's "evident partiality" standard requires vacatur when an arbitrator's conduct creates even an "appearance of bias." *Commonwealth Coatings*, 393 U.S. at 148, 150. As a matter of law, imposing punitive damages "*in retaliation* for the very fact" that a party made a good-faith disqualification challenge to the arbitrator's continued service, App. 16a-17a (emphasis added), creates at least that.

3. The Record In This Case Establishes "Clear Partiality" On The Arbitrator's Part

Either ground, standing alone, fully supported the district court's finding of "evident partiality" in this case. In combination with remainder of the record before the district court, there can be no doubt. *See Thomas Kinkade Co. v. White*, 711 F.3d 719, 724 (6th Cir. 2013) (A "convergence of undisputed facts," "considered together," can show partiality.); *ANR Coal Co. v. Cogentrix of N. Carolina, Inc.*, 173 F.3d 493, 501 n.5 (4th Cir.) (The "cumulative effect" of multiple actions can impact partiality.), *cert. denied*, 528 U.S. 877 (1999); *United States v. International Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers*, 814 F. Supp. 1165, 1175 (S.D.N.Y. 1993) (A court should

"consider the totality of the circumstances in deciding the existence of evident partiality.").

The Ninth Circuit held that the arbitrator's "brother's litigation practice . . . 'would [not] cause a person reasonably to doubt [his] impartiality.'" App. 2a (second alteration in original) (citation omitted); *see* Oral Argument at 20:37-20:48 ("If you found out that my brother, who's a lawyer, had once sued your client, you could not get me recused from this panel, no matter what process we used."). Even if Masimo's disqualification challenge had been based simply on the arbitrator's "brother's litigation practice," that would not justify the arbitrator's decision to decide the disqualification challenge on his own, or to impose punitive damages for bringing that challenge.

But that is a gross distortion of the basis for Masimo's disqualification challenge. As the district court observed, the situation here is "much more serious." App. 17a. Masimo's disqualification challenge was not based on the mere fact that Stephen Neal "had once sued" Masimo. It was based on the fact that Stephen Neal had recently represented Masimo's chief competitor and suffered "two high-stakes, high-profile, back-to-back" devastating losses, costing his client over half a billion dollars in damages and the right to market its competing medical device. App. 18a.

In the judicial context, courts have recognized that an appearance of partiality may arise because of the "natural assumption that brothers enjoy a close personal and family relationship" and the "consequen[ce] [that they] would be inclined to support each other's interests." *SCA Servs., Inc. v. Morgan*, 557 F.2d 110, 116 (7th Cir. 1977). Such interests can be financial, reputational, or even personal. *See, e.g.*, *In re*

Specht, 622 F.3d 697, 699 (7th Cir. 2010) (noting that nonpecuniary interests, such as reputation, could form the basis for recusal based on a family member being "substantially affected"); *Regional Sales Agency, Inc. v. Reichert*, 830 P.2d 252, 258 (Utah 1992) (recognizing potential appearance of partiality based on "goodwill and reputation"); *SCA Servs.*, 557 F.2d at 115-16 (explaining that "non-economic interests may affect a judge's bias or prejudice"). A reasonable party could easily conclude that it would not want to put its fate in the hands of a decisonmaker whose own brother had suffered such substantial losses to that party.

In combination with the rest of the arbitrator's improper conduct, Stephen Neal's past representation of Masimo's rival and his brother's summary denial of Masimo's disqualification motion on that basis created at least the *appearance* of bias. The Ninth Circuit's decision nevertheless finding no "evident partiality" in this case deprives that safeguard of meaning.

D. The Proper Application Of The "Evident Partiality" Standard Is Unquestionably Important

The proper application of the "evident partiality" standard is undeniably important. Over the past several decades, private arbitration has become "[a] veritable surrogate for the public justice system." Thomas J. Stipanowich, *Punitive Damages & Consumerization of Arbitration*, 92 Nw. U. L. Rev. 1, 3 (1997). In a recent study, researchers found that seventy-five percent of consumer contracts and more than ninety percent of employment contracts require that any dispute be resolved through binding arbitration. *See* Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study*

of Arbitration Clauses in Consumer and Nonconsumer Contracts, 41 U. Mich. J.L. Reform 871, 882-83 (2008). A great deal of this arbitration is conducted by JAMS and governed by the rules governing the arbitration in this case.

If this alternative system of justice is to protect the due process interests of its participants, it must be "built, like the public justice system, on the foundation of fundamental fairness." Stipanowich, *supra*, at 6. For reasons of efficiency and freedom of contract, Congress and this Court have sharply limited the instances where courts can disturb an arbitrator's resolution of a dispute. But those limits only reinforce the fact that parties to arbitration, as in any other justice system, "are entitled to a hearing before an impartial and independent decisionmaker." *Id.* Confusion has spread in the lower courts over the scope of the "evident partiality" standard in the wake of *Commonwealth Coatings*. And the Ninth Circuit's decision in this case all but eviscerates this critical safeguard. This Court's guidance is necessary.

II. THE NINTH CIRCUIT'S WAIVER RULING WARRANTS THIS COURT'S REVIEW

The Ninth Circuit's separate ruling that Masimo—the appellee below—waived the crux of an alternative argument that the district court did not reach by not making that argument on appeal also conflicts with the decisions of other circuits and warrants further review.

A. The Ninth Circuit Based Its Decision On An Indefensible Waiver Rule

In the district court, Masimo not only argued that the arbitrator's award should be vacated for "evident partiality," but also because the award displayed a

"manifest disregard of the law." *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 656 (1985). That challenge was based on two glaring legal errors that the arbitrator made—by imposing a constitutionally excessive punitive damages award based on dissimilar, potential harm to third parties not before the Court; and by refusing to afford collateral-estoppel effect to the district court's summary judgment order from the *qui tam* suit. Masimo Mot. to Vacate at 10-19.

Because the district court concluded that the award must be vacated in its entirety based on the arbitrator's "clear partiality" against Masimo, it never passed on Masimo's separate "manifest disregard" challenge. App. 19a. On appeal, Masimo defended the district court's judgment on its own terms; it did not elaborate on why the award was invalid on other grounds. It did, however, make crystal clear that, should the Ninth Circuit reverse, it would renew its alternative arguments before the district court on remand. Masimo CA9 Br. at 8 n.1, 48.

After erroneously reversing the district court's "evident partiality" ruling, however, the Ninth Circuit proceeded to reject Masimo's distinct "manifest disregard" challenge and ordered the district court to enforce the "arbitration award in its entirety." App. 3a. According to the court, Masimo had somehow *waived* the crux of this challenge—its due process arguments challenging the punitive damages award—by not raising it as an alternative ground for affirmance on appeal. *See id.* at 2a n.1 ("The concurrence argues that the amount of the punitive damages award—sixteen times the compensatory damages award—raises due process concerns. However, neither party

raised this issue on appeal, and, therefore, it was waived."). That ruling not only gutted Masimo's separate "manifest disregard" argument, but directly conflicts with the decisions of other Circuits.

B. The Ninth Circuit's Waiver Rule Directly Conflicts With The Decisions Of Other Circuits

It has long been accepted that "[t]he urging of alternative grounds for affirmance is a privilege rather than a duty." *Schering Corp. v. Illinois Antibiotics Co.*, 89 F.3d 357, 358 (7th Cir. 1996). If an appellee prefers to confine his arguments on appeal to the grounds on which *he won* below, rather than crowd his appellate brief with every possible alternative ground for affirmance, that has long been his right—and a prudent choice. *See* Antonin Scalia & Bryan A. Garner, *Making Your Case: The Art of Persuading Judges* 22 (2008) ("The most important—the very important—step you will take in any presentation . . . is selecting the arguments that you'll advance. . . . Scattershot argument . . . gives the impression of weakness and desperation, and it insults the intelligence of the court."). "[U]nlike an *appellant's* failure to raise all possible grounds for reversal," an *appellee's* choice not "to have raised all possible alternative grounds for affirming the district court's original decision . . . should not operate as a waiver." *Schering Corp.*, 89 F.3d at 358 (emphasis added).

Every other Circuit to have addressed this issue has agreed. *See Eichorn v. AT&T Corp.*, 484 F.3d 644, 657-58 (3d Cir.) ("[T]he defendants were the *appellees* in the previous appeal. As such, they were not required to raise all possible alternative grounds for affirmance to avoid waiving those grounds."), *cert.*

denied, 552 U.S. 1071 (2007); *Independence Park Apartments v. United States*, 449 F.3d 1235, 1240 (Fed. Cir. 2006) ("As appellee, the government was not required to raise all possible alternative grounds for affirmance in order to avoid waiving any of those grounds."); *Kessler v. National Enters., Inc.*, 203 F.3d 1058, 1059 (8th Cir. 2000) ("[A]ppellate courts should not enforce the [waiver] rule punitively against appellees . . . ."); *Crocker v. Piedmont Aviation, Inc.*, 49 F.3d 735, 740-41 (D.C. Cir.) ("[T]he *only* context in which we have ever . . . applied the waiver doctrine" is "by requiring appellants to bring all of their objections to a judgment in a single appeal," not "forcing appellees to put forth every conceivable alternative ground for affirmance."), *cert. denied*, 516 U.S. 865 (1995).

The Ninth Circuit's waiver ruling in this case is irreconcilable with those decisions.

C. The Ninth Circuit's Waiver Rule Is Fundamentally Unfair And Unsound

The rule followed by the other Circuits is unassailable. "While there are clear adjudicative efficiencies created by requiring appellants to bring all of their objections to a judgment in a single appeal rather than *seriatim* . . . , forcing appellees to put forth every conceivable alternative ground for affirmance might increase the complexity and scope of appeals more than it would streamline the progress of the litigation." *Crocker*, 49 F.3d at 740. Such a rule would detract from the appellee's presentation of the principal issues on appeal—thereby providing the court less guidance on the key issues, while multiplying the number of others. And it would encourage appellees to file a cross-appeal in every case. *See Kessler*, 203 F.3d at 1059. Such unnecessary cross-appeals themselves

would "impos[e] significant burdens on the appellate court," *Crocker*, 49 F.3d at 710, but without one, despite having *prevailed* below, an appellee would find himself at a distinct disadvantage to the appellant on appeal. Appellees would be required to raise not only every claim of *error* in what the district court had actually held, but (as in this case) argue every ground for victory that the district court could have, but reasonably did not, adopt. And they would be required to do so all without the privilege of a reply brief.

Here, the district court never passed on Masimo's "manifest disregard" argument and so did not need to rule on whether the arbitrator's punitive damages award—sixteen times the amount of compensatory damages—violated due process. And the only relevance of this argument to the appeal was as an alternative grounds to affirm a judgment that the Ninth Circuit never should have reached. Masimo reasonably—and permissibly—decided not to ask the Ninth Circuit to consider the issue for the first time on appeal, expressly reserving that argument twice in its brief. *See* Masimo CA9 Br. 8 n.1, 48. Yet the Ninth Circuit inexplicably held that Masimo "waived" its due process challenge to the punitive damages award.

That waiver ruling was clearly prejudicial. As Judge Hurwitz recognized, the arbitrator's punitive damages award in this case raises "obvious due process concerns" given its 16-to-1 ratio to compensatory damages, not to mention the fact that it was based on *potential* harm to *third parties*. App. 4a. It directly conflicts with the decisions of other circuits. It is an affront to this Court's due process jurisprudence and to the proper administration of the appellate process. And it independently warrants this Court's review.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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May 18, 2016

APPENDIX

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MOLLY C. DWYER, CLERK
U.S. COURT OF APPEALS

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MICHAEL RUHE and VICENTE CATALA, Plaintiffs - Appellants, Cross-Appellee v. MASIMO CORPORATION, Defendant - Appellee. Cross-Appellant	No. 14-55556 14-55725 D.C. No. 8:11-cv-00734-CJC-JCG MEMORANDUM*

Appeal from the United States District Court
for the Central District of California
Cormac J. Carney, District Judge, Presiding

Argued and Submitted February 1, 2016
Pasadena, California

Before: PREGERSON, WARDLAW, and HURWITZ, Circuit Judges.

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* This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36-3.

Michael Ruhe and Vicente Catala appeal the district court's order vacating an arbitration award against Masimo Corporation. We have jurisdiction pursuant to 9 U.S.C. § 16(a)(1)(E), and we reverse.

The district court erred in holding that the arbitrator exhibited "evident partiality." 9 U.S.C. § 10(a)(2). Masimo did not establish that the arbitrator "failed to disclose to the parties information that creates '[a] reasonable impression of bias.'" *Lagstein v. Certain Underwriters at Lloyd's, London*, 607 F.3d 634, 646 (9th Cir. 2010) (alteration in original) (quoting *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996)). As the arbitrator noted, Masimo "furnish[ed] no coherent explanation" as to how his brother's litigation practice or his role in a SIDS foundation "would cause a person reasonably to doubt [his] impartiality in this case." Nor did Masimo "establish specific facts indicating actual bias." *Id.* at 645–46. Although the arbitrator committed an error in applying Third Circuit instead of California law as to punitive damages, that was not the central basis for the punitive damages award. Moreover, that error did not rise to the level of "affirmative misconduct" or "irrational[ity]." *Douglas v. U.S. Dist. Court for Cent. Dist. of Cal.*, 495 F.3d 1062, 1068 (9th Cir. 2007) (per curiam) (alteration in original) (quoting *Kyocera Corp. v. Prudential– Bache Trade Servs., Inc.*, 341 F.3d 987, 998 (9th Cir. 2003) (en banc)).

For the same reason, Masimo's remaining challenges to the arbitration award are unavailing.[1]

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[1] The concurrence argues that the amount of the punitive damages award—sixteen times the compensatory damages award—raises due process concerns. However, neither party

The arbitrator's rulings, even if erroneous, did not "exceed his powers" or rise to the level of manifest disregard of the law. *Biller v. Toyota Motor Corp.*, 668 F.3d 655, 665 (9th Cir. 2012) ("[A]rbitrators exceed their powers . . . not when they merely interpret or apply the governing law incorrectly, but when the award is completely irrational . . . ." (citation omitted)); *Collins v. D.R. Horton, Inc.*, 505 F.3d 874, 879 (9th Cir. 2007) ("The manifest disregard exception requires 'something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand and apply the law.'" (quoting *San Martine Compania De Navegacion, S.A. v. Saguenay Terminals Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961)). Accordingly, on remand, the district court is directed to issue an order confirming the arbitration award in its entirety.

REVERSED AND REMANDED.

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raised this issue on appeal, and, therefore, it was waived. Moreover, the Supreme Court has recognized that "low awards of compensatory damages may properly support a higher ratio" of punitive to actual damages. *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 582 (1996). That is especially true where, as here, the low award of compensatory damages reflects the plaintiffs' successful efforts to mitigate their damages, and not the reprehensibility of the defendants' conduct.

HURWITZ, Circuit Judge, concurring:

The Federal Arbitration Act permits a district court to vacate an arbitration award "only in very unusual circumstances." *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 942 (1995). Although I am troubled by this case, I am unable to conclude that one of the "narrow grounds" in section 10(a) of the Act justifies the district court's refusal to confirm the arbitrator's award. *See Collins v. D.R. Horton, Inc.*, 505 F.3d 874, 883 (9th Cir. 2007) (quoting *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1133 (9th Cir. 2000)).

In general, an arbitrator should not himself determine whether he should be recused, given his financial interest in continued employment. *See Pitta v. Hotel Ass'n of N.Y. City, Inc.*, 806 F.2d 419, 423-24 (2d Cir. 1986). Thus, regardless of the JAMS procedural rules, the arbitrator should have referred Masimo's belated request for recusal to another for decision. But, because the recusal request raised only matters of general public knowledge and occurred very late in an extended arbitration (when the arbitrator had earned virtually all of his fees), and because Masimo's claims of "evident partiality" fail on the merits, any error by the arbitrator in not referring the issue to others does not mandate vacation of the award.

The punitive damages award also gives me concern. As my colleagues note, the judge applied the wrong law; he thus incorrectly based the amount of the award in part on the conduct of Massimo's attorneys during the arbitration. Moreover, the amount of the award, about sixteen times the amount of compensatory damages, raises obvious due process concerns. *See BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 581-82

(1996). But, section 10(a)(4) of the Act only allows a court to refuse to confirm an award when the arbitrator exhibits "manifest disregard of the law." *Comedy Club, Inc. v. Improv W. Assocs.*, 553 F.3d 1277, 1289-90 (9th Cir. 2009). Like my colleagues, I cannot conclude that this very demanding standard was met here.

UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

Michael RUHE and Vicente Catala, Plaintiffs,

v.

MASIMO CORPORATION, Defendant.

Case No. SACV 11–00734–CJC(JCGx).

Signed April 3, 2014.

14 F. Supp. 3d 1342

ORDER GRANTING DEFENDANT'S MOTION TO VACATE FINAL ARBITRATION AWARD

CORMAC J. CARNEY, District Judge

I. INTRODUCTION

In September 2011, the Court ordered the parties to arbitrate Plaintiffs Michael Ruhe and Vicente Catala's claims that they were constructively discharged from Defendant Masimo Corporation because of undue pressure Masimo placed on them to sell its medical devices despite allegedly knowing that the devices were inaccurate and defective. Thirty-six hours before the final hearing in the arbitration, Masimo's counsel made a for-cause challenge to the continued service of the arbitrator, Retired Justice Richard C. Neal (the "Arbitrator") of Judicial Arbitration and Mediation Services ("JAMS"). The challenge was based on Masimo's recent discovery that the Arbitrator's brother had represented its chief competitor in two highly contentious litigation losses to Masimo with liability verdicts totaling over half a billion dollars. Instead of having the challenge heard by JAMS as required by JAMS's rules, the Arbitrator

himself determined that he was not subject to disqualification and issued his final award, imposing $5 million in punitive damages against Masimo. This large punitive damage award, more than 16 times the compensatory damage award, was based in part on what the Arbitrator characterized as "abusive litigation tactics" by Masimo's counsel in the arbitration, including the fact that Masimo's counsel sought his disqualification. Masimo now moves to vacate the arbitration award. (Dkt. No. 49.) After considering the evidence presented by the parties and carefully reviewing the Arbitrator's written decision, the Court concludes that the arbitration award must be vacated. The Arbitrator demonstrated evident partiality by awarding excessive and improper punitive damages in retaliation for Masimo's counsel challenging his impartiality and taking other reasonable measures to zealously represent their client.[1]

II. BACKGROUND

Masimo develops, manufactures, and sells non-invasive patient-monitoring medical devices. (Dkt. No. 51 ["Everton Decl."] Exh. 2 ["Final Award"] at 4–5.) Its first and leading category of products are devices known as pulse oximeters. Pulse oximeters, first introduced in the 1980s, measure oxygen saturation in the blood ("SpO_2") by analyzing wavelengths of light through a sensor clipped to the patient's finger. Previously, measuring blood oxygen required drawing a blood sample from the patient and sending it away to be analyzed in a laboratory. Early pulse oximeters were susceptible to inaccurate readings when the

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[1] In light of the Court's ruling, Plaintiffs' motion to confirm the arbitration award, (Dkt. Nos. 29–30), is DENIED.

patient moved or had low blood flow. Masimo's founders invented advanced sensor technology that provided reliable readings under these conditions, and this technology became the basis for its pulse oximetry devices. Masimo's latest line of devices measure an additional blood constituent known as total hemoglobin ("SpHb"). The first of these devices, the Radical–7, was cleared by the Food and Drug Administration ("FDA") in May 2008. (Final Award at 8.) The devices primarily at issue in this action are the Pronto and Pronto–7 (together, the "Pronto Devices"), and were cleared by the FDA in October 2008 and June 2010, respectively. (*Id.*)

Plaintiffs were hired as sales representatives at Masimo in December 2008 and March 2009. (*Id.*) They were two of the sales representatives assigned to sell the new line of Pronto Devices. Plaintiffs experienced difficulty getting physicians and clinics to buy the new devices, which Plaintiffs attributed to problems with device accuracy. For instance, Mr. Ruhe did a product demonstration of the Pronto during a sales call with two doctors in January 2009, and the device displayed "significant variations in back to back readings among several doctors." (*Id.*) The doctors did not purchase the device. According to Plaintiffs, they reported to Masimo their difficulty selling the devices because of physicians' concerns about accuracy, but their complaints were met with "pressure and insistence that the [sales representatives] continue their efforts to sell the devices." (*Id.* at 13.) Plaintiffs' sales of the devices "had fallen off drastically" by mid–2010, and they were put on remedial performance plans. (*Id.* at 14.) In August 2010, Plaintiffs consulted an attorney, Mr. Bonagofsky, who would subsequently represent

them in this action. (*Id.* at 19.) In October 2010, Plaintiffs downloaded thousands of Masimo documents and then resigned from the company. (*Id.* at 16–17.) Plaintiffs submitted their resignation letters on October 22, 2010. One week later, Plaintiffs filed their complaint against Masimo in the related action, *United States ex rel. Michael Ruhe, et al. v. Masimo Corporation*, Case No. SACV 10–08169–CJC(VBKx) (the "*Qui Tam* Action").

In the *Qui Tam* Action, Plaintiffs sought damages from Masimo under the Federal False Claims Act, 31 U.S.C. § 3729 *et seq.*, asserting that Masimo made misrepresentations to the FDA and medical providers in connection with the Pronto Devices. Plaintiffs alleged, *inter alia*, that Masimo made misrepresentations regarding the devices' FDA-cleared indications for use, misrepresentations regarding validation studies, and misrepresentations regarding the devices' ability to perform to their FDA-cleared accuracy specification.[2] (*See Qui Tam* Action, Dkt. No. 52 at 14–15.)

Seven months after filing the *Qui Tam* Action, Plaintiffs filed their complaint in this employment case.[3] Plaintiffs asserted claims for constructive discharge in violation of the whistleblower protections of the Dodd–Frank Wall Street Reform and Consumer

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[2] The FDA granted clearance for Masimo to market the devices with an SpHb accuracy specification of +/− 1 gram per deciliter ("g/dL") at one standard deviation, which encompassed 68% of the population. (Final Award at 6.)

[3] The *Qui Tam* Action was under seal pending the United States' decision to intervene. After the United States elected not to intervene in November 2011, the action went forward.

Protection Act of 2010, 15 U.S.C. § 78u–6(h); retaliation in violation of California Labor Code section 1102(c); "wrongful constructive termination" in violation of public policy; and unfair competition in violation of California Business and Professions Code section 17200 *et seq.*[4] (Final Award at 25–29; Dkt. No. 1 ["Compl."].) The Court compelled the employment action to arbitration on September 16, 2011, 2011 WL 4442790. At some point in the proceeding, the arbitration apparently evolved into a plenary review of Masimo's medical devices and the minutiae of the company's compliance with FDA regulations. The parties were allowed to present evidence over ten days of hearings before the Arbitrator in early February 2013. Closing arguments were held in July 2013.

Meanwhile, the *Qui Tam* Action was proceeding in parallel. Pursuant to the scheduling order, trial was set for October 29, 2013, and all motions had to be heard by September 20, 2013. (*See Qui Tam* Action, Dkt. No. 52.) In light of the motion deadline, Masimo filed its motion for summary judgment on August 19, 2013, set for hearing on September 16, 2013. (*Qui Tam* Action, Dkt. No. 117.) The Court issued its order granting Masimo's motion for summary judgment on October 2, 2013. (*See Qui Tam* Action, Dkt. No. 255.) The Court found that Plaintiffs failed to demonstrate

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[4] Masimo brought counterclaims in the arbitration against Plaintiffs for conversion and breach of contract. (*See* Everton Decl. Exh. 19.) Beginning months before they quit, Plaintiffs allegedly stole "thousands of Masimo's confidential files, emails, and other confidential documents." (*Id.* at 1.) Plaintiffs had signed confidentiality agreements. (*Id.* at 8–9.) Despite the fact that the parties fully briefed Masimo's counterclaims, (*see id.*), the Arbitrator never ruled on them.

any knowingly misleading statements or conduct by Masimo in connection with the Pronto Devices. (*Id.* at 14–22.) Because the summary judgment order decided issues arguably identical to issues underpinning the employment arbitration, Masimo requested permission from the Arbitrator to brief the collateral estoppel effect of the order. The Arbitrator, who had already prepared "a substantial draft award [that was] near completion," (Final Award at 22), stated that he was "not happy about further delaying release" of the award, (Dkt. No. 58 ["Dickson Decl."], Exh. A). However, "[a]s there appeared to be overlap between the summary judgment order and the issues presented in the arbitration," the Arbitrator agreed that briefing was necessary. (Final Award at 2.) The briefing was completed October 21, 2013. (*Id.* at 20.) One week later, the Arbitrator issued an interim award finding in favor of Plaintiffs on their constructive termination claim and making the predicate finding for punitive damages. (Everton Decl., Exh. 1.) The Arbitrator directed the parties to submit briefing on the quantum of punitive damages and attorneys' fees, and set a hearing date of January 10, 2014. (Final Award at 2.)

On the evening of January 8, 2014, thirty-six hours before the final arbitration hearing, counsel for Masimo sent a letter to the Arbitrator challenging his continued service in the arbitration. (Everton Decl., Exh. 23 ["Challenge Letter"].) The letter stated that in the past twenty-four hours Masimo had learned of information raising serious doubts about the Arbitrator's ability to be impartial toward Masimo. From 2004 to 2006, Masimo was embroiled in litigation with its chief competitor in the pulse oximetry market,

Nellcor Puritan Bennett, Inc.[5] In 2004, after a six-week trial in Los Angeles, a jury found for Masimo on all of its patent infringement claims against Nellcor and awarded $164 million in damages.[6] *See Mallinckrodt, et al. v. Masimo Corp.*, Case No. CV 00–06506–MRP(AJWx). Then, in 2005, Masimo brought an antitrust action alleging that Nellcor engaged in anti-competitive conduct in the sale of its pulse oximetry devices. *See Masimo Corp. v. Tyco Healthcare Group, L.P., et al.*, Case No. CV 02–04770–MRP(AJWx). Following a four-week trial in Los Angeles, the jury found that Nellcor's conduct violated the antitrust laws and awarded Masimo $420 million in damages. This verdict was reported as 2005's fifth-largest jury verdict and the third largest in California. (Everton Decl., Exh. 24 at 28–32.) What Masimo's counsel discovered shortly before the final arbitration hearing was that the attorney who represented Nellcor during both actions, suffering two high-stakes, high-profile, back-to-back losses to its longtime rival, was Stephen C. Neal—the Arbitrator's brother. (Challenge Letter at 1.)

Rather than having JAMS decide Masimo's disqualification challenge, the Arbitrator denied the challenge the next day. (Everton Decl., Exh. 23.) The

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5 Nellcor's parent companies, Mallinckrodt, Inc. and Tyco Healthcare Group, L.P., were the named parties in these cases.

6 On appeal before the United States Court of Appeals for the Federal Circuit, the infringement verdict was affirmed in substantial part and the circuit held that a permanent injunction should have been issued against Nellcor prohibiting it from marketing the infringing products. *See Mallinckrodt, Inc. v. Masimo Corp.*, 147 Fed.Appx. 158, 187 (Fed.Cir.2005).

Arbitrator stated that he was not previously aware of his brother's representation of Masimo's rival or the defeats his brother had suffered, that he violated no disclosure obligations, and that even if he had known of the information, it was not "sufficient to cause a person to reasonably doubt [his] ability to be impartial in this case" because "[n]o advantage could flow to [him] from disfavoring a company simply because [his] brother was [a] lawyer for a Masimo opponent." (*Id.*) The punitive damages hearing proceeded as scheduled on January 10, 2014.

Five days after the hearing, the Arbitrator issued the final award in the arbitration. The Arbitrator found that Plaintiffs had not shown Masimo retaliated against them in any regard, finding that "[t]here is no evidence that [Masimo's] insistence that the [sales representatives] keep selling was motivated by a desire to 'repay' Plaintiffs for complaining, or to punish or obtain revenge against them for protected activity." (Final Award at 28.) Accordingly, the Arbitrator found against Plaintiffs on their whistleblower retaliation claims under California Labor Code section 1102.5(c) and the Dodd–Frank Act. (*Id.*) With regard to the wrongful constructive termination claim, however, the Arbitrator found that Masimo "pressured [Plaintiffs] to sell and continue selling, and to tout the virtues of, medical devices which abundant experience and evidence showed were faulty and did not perform as claimed." (*Id.* at 25.) This "corporate environment," the Arbitrator concluded, "is no less intolerable for an honest, diligent employee, than one rife with racial prejudice or sexual harassment." (*Id.* at 26.) Consequently, the Arbitrator found in favor of Plaintiffs on their wrongful constructive termination

claim and awarded them the full amount of economic damages they requested, $210,056, as well as $100,000 in general damages. (*Id.* at 29.)

Then the Arbitrator turned to the issue of punitive damages.[7] The Arbitrator found that Masimo "knowingly compelled" its sales force "to sell devices which they and [Masimo] knew to be unreliable," and that Masimo's sales force was harmed by this conduct. (*Id.* at 32.) The Arbitrator further found that "doctors and clinicians who were the subject of this campaign were harmed by being induced to purchase the devices [and] the patients whose treatments involved reliance on the devices were at risk of harm, and in at least one instance actually harmed." (*Id.*)

After this brief discussion of Masimo's conduct, the Arbitrator then detailed what he perceived to be "a series of questionable and abusive tactics" undertaken by Masimo's counsel in the arbitration. (*Id.*) The Arbitrator cited three main instances of supposed misconduct by Masimo's attorneys: first, requesting that the Arbitrator withdraw, which the Arbitrator called "unjustified factually or legally"; second, arguing for application of collateral estoppel based on the Court's summary judgment order in the *Qui Tam* Action; and third, making the argument, as characterized by the Arbitrator, that "U.S. Supreme Court authority bar[s] consideration of potential harm to others in determining reprehensibility for quantifying punitive damages." (*Id.* at 34.) The Arbitrator stated that Masimo's punitive damages

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[7] The Arbitrator agreed that due process and constitutional standards applied and stated that the award would conform to those standards. (Final Award at 35.)

brief, specifically its citation of *Philip Morris*, "outright misstated the law" on the critical issue of third-party harm. (*Id.* at 34, 37–38; *see also* Everton Decl., Exh. 15 ["Masimo Punitive Damages Br."] at 18–19 (citing *Philip Morris USA v. Williams*, 549 U.S. 346, 127 S.Ct. 1057, 166 L.Ed.2d 940 (2007); *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 424, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003)).) The Arbitrator awarded punitive damages of $5 million—$2.5 million to each Plaintiff. (Final Award at 38.) He acknowledged that this was 16 times the total compensatory damages awarded, but reasoned that it was "in no sense disproportionate [because] it is only a fraction of [Masimo's] annual net income." (*Id.* at 39.)

III. ANALYSIS

Section 10(a) of the Federal Arbitration Act ("FAA") provides the circumstances under which a federal district court may vacate an arbitration award.[8]

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[8] Section 10(a) states, in its entirety:

> In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

An award may be vacated "where there was evident partiality or corruption in the arbitrator[ ]." 9 U.S.C. § 10(a)(2). Although the FAA was enacted to encourage the expeditious resolution of disputes through arbitration, "it was [not] the purpose of Congress to authorize litigants to submit their cases and controversies [to arbitrators who] might reasonably be thought biased against one litigant and favorable to another." *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 147, 89 S.Ct. 337, 21 L.Ed.2d 301 (1968). Under the evident partiality standard, the party challenging the award has the burden "of proving facts which would establish a reasonable impression of partiality." *Sheet Metal Workers Int'l Ass'n Local Union No. 420 v. Kinney Air Conditioning Co.*, 756 F.2d 742, 746 (9th Cir.1985); *see also Schmitz v. Zilveti*, 20 F.3d 1043, 1048 (9th Cir.1994). This showing requires "specific facts indicating improper motives" on the part of the arbitrator. *Toyota of Berkeley v. Auto. Salesman's Union, Local 1095*, 834 F.2d 751, 755 (9th Cir.1987); *see also Scandinavian Reinsurance Co. v. Saint Paul Fire & Marine Ins. Co.*, 668 F.3d 60, 72 (2d Cir.2012) (the evident partiality standard is met "when a reasonable person, considering all the circumstances, would *have* to conclude that an arbitrator was partial") (internal citation and quotation marks omitted).

The Arbitrator demonstrated evident partiality by deciding Masimo's disqualification challenge himself and then imposing punitive damages against Masimo in

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(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

retaliation for the very fact that Masimo made the challenge. Rule 15(i) of the JAMS Employment Arbitration Rules & Procedures gives any party the right to make a for-cause challenge to the continued service of the arbitrator at any time during the arbitration. (Everton Decl., Exh. 27 ["JAMS Emp't Arbitration Rules"].) After a challenge is made, the opposing party has seven days to respond. Then "JAMS shall make the final determination as to such challenge." JAMS Emp't Arbitration Rules, Rule 15(i).

While Rule 15(i) is not controlling in this case, the fact that the Arbitrator disregarded the procedures set in place by his own organization and unilaterally determined that there was no cause for his disqualification is compelling evidence of his partiality. Rule 15(i) is not a mere formality. It reflects the wise policy that the final determination on challenges of bias should not be made by the presiding officer who is alleged to be biased.[9] The Arbitrator's ruling on Masimo's challenge was dismissive of the potential conflict, stating that it was merely based on the fact that his brother "represented companies adverse to Masimo in litigation." (Final Award at 2.) The circumstances in reality were much more serious. In the lucrative market for pulse oximetry medical devices, Masimo and Nellcor were Coke and Pepsi.

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[9] The American Arbitration Association ("AAA") has a substantively identical rule: "Upon objection of a party to the continued service of an arbitrator, or on its own initiative, the AAA shall determine whether the arbitrator should be disqualified [for grounds including partiality or lack of independence], which decision shall be conclusive." AAA, *Employment Arbitration Rules and Mediation Procedures*, Rule 16 (effective November 1, 2009).

The Arbitrator's brother, chairman of the firm Cooley LLP, represented Nellcor in two high-stakes, high-profile litigation losses to Masimo. Masimo was awarded over half a billion dollars in damages and won a permanent injunction under which Nellcor had to stop selling its current line of pulse oximeters and had to pay royalties to Masimo on the sale of its future devices. The integrity of the process required that the challenge be referred to JAMS for determination in accordance with JAMS's rules, under which the parties had agreed to arbitrate. Especially in light of the stakes at issue—a $5.4 million award—a modest delay to obtain a ruling from JAMS would be no great burden on the parties or the Arbitrator. The Arbitrator's decision to decide Masimo's challenge himself, without even making additional disclosures or providing facts on the record to refute the alleged conflict, undermined the fairness of the proceeding and demonstrated his partiality. *See Pitta v. Hotel Ass'n of N.Y. City, Inc.*, 806 F.2d 419, 424 (2d Cir.1986) ("An even stronger risk of unfairness exists here where the arbitrator, acting alone, determines the validity of his own dismissal.").

But this was not all the Arbitrator did. He used the very fact that Masimo's counsel made the challenge as a basis for imposing punitive damages against Masimo, further demonstrating evident partiality. (*See* Final Award at 34.) It is well settled in California that "a defendant's trial tactics and litigation conduct may not be used to impose punitive damages in a tort action."[10]

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[10] Although the Arbitrator clearly applied California law in deciding all other questions relating to punitive damages, he relied on a Third Circuit decision applying Pennsylvania law for the proposition that "abusive litigation tactics are properly considered in fixing the amount of punitive damages." (*See* Final Award at

Bosack v. Soward, 586 F.3d 1096, 1105 (9th Cir.2009) (quoting *De Anza Santa Cruz Mobile Estates Homeowners Ass'n v. De Anza Santa Cruz Mobile Estates*, 94 Cal.App.4th 890, 918, 114 Cal.Rptr.2d 708 (2001)). Punitive damages cannot be "based on evidence that a defendant filed motions, appeals and other legal proceedings during the course of litigation, or opposed motions filed by the other party." *De Anza*, 94 Cal.App.4th at 918, 114 Cal.Rptr.2d 708. Doing so would improperly impose liability on the client for the litigation tactics of its counsel. *See Palmer v. Ted Stevens Honda, Inc.*, 193 Cal.App.3d 530, 539, 238 Cal.Rptr. 363 (1987). It would also impair a defendant's right to vigorously defend charges brought against it. *See De Anza*, 94 Cal.App.4th at 919, 114 Cal.Rptr.2d 708 ("A person's right of access to judicial and quasi-judicial bodies to decide controversies is a fundamental component of our society that cannot be impaired by the threat of punishment or retaliation."); *see generally Cal. Teachers Ass'n v. State*, 20 Cal.4th 327, 338–39, 84 Cal.Rptr.2d 425, 975 P.2d 622 (1999). Contrary to the Arbitrator's belief, Masimo's counsel had every right to challenge his impartiality. The Arbitrator's own brother had represented Masimo's longtime rival and suffered back-to-back losses to Masimo with over half a billion dollars in damages levied against his client. Masimo's counsel properly raised the challenge to the Arbitrator's impartiality, and the Arbitrator, in any event, never should have punished Masimo for making the challenge. The Arbitrator's handling of the issue demonstrates clear partiality on his part. *Cf. Toyota of Berkeley*, 834 F.2d at 757 (arbitrator's filing of

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32–33 (citing *CGB Occupational Therapy, Inc. v. RHA Health Servs., Inc.*, 499 F.3d 184 (3d Cir.2007)).)

sanctions against party's counsel supported a "serious allegation" of bias but did not establish evident partiality because he sought sanctions against the party's attorney rather than the party itself).

The Arbitrator further demonstrated partiality by punishing Masimo for its counsel arguing that the summary judgment order in the *Qui Tam* Action had collateral estoppel effect. (Final Award at 34.) The *Qui Tam* summary judgment order was a final judgment on the merits, in an action between the same parties. Any issues decided by the order potentially had preclusive effect in the arbitration. *See Aircraft Braking Sys. Corp. v. Local 856, Int'l Union, United Auto., Aerospace & Agr. Implement Workers, UAW*, 97 F.3d 155, 159 (6th Cir.1996) ("[C]ircuits ... have held uniformly that arbitrators are bound by prior federal court decisions under the doctrine[ ] of collateral estoppel.") (collecting cases). One of the key findings of the order was that Masimo had not misled the FDA or medical providers with respect to the clearance, marketing, or sale of the Pronto Devices. (*Qui Tam* Action Dkt. No. 255 at 14–22.) This determination appeared to overlap with an issue central to Plaintiffs' constructive termination claim in the arbitration: whether Masimo "engaged in a long-running course of selling devices to doctors and clinics accompanied by performance claims, in particular the accuracy specification, which [Masimo] knew were false." (*See* Final Award at 27.) Indeed, the Arbitrator himself acknowledged that "certain determinations in the summary judgment order appeared to overlap with issues in the arbitration," and therefore "ordered the parties to brief the impact of the order on the arbitration." (*Id.* at 20.) In the Final Award, however,

the Arbitrator used the very fact that Masimo argued for collateral estoppel as a reason to impose punitive damages on Masimo. (*See id.* at 34) ("[Masimo's] attempt to use the *qui tam* summary judgment to foreclose a decision on the merits in the arbitration also can be seen, in the context of the other conduct just discussed, to be abusive."). Masimo had every right to argue that the summary judgment order had collateral estoppel effect.[11] That the Arbitrator characterized this conduct by Masimo's counsel as "abusive" and then imposed punitive damages on Masimo is further evidence of his partiality.

Finally, the Arbitrator demonstrated evident partiality by imposing punitive damages on Masimo for its counsel's argument distinguishing the Supreme Court's decision in *Philip Morris*. The Arbitrator characterized Masimo's brief as "outright misstat[ing]" *Philip Morris's* holding that "conduct that risks harm to others [may be considered] in determining reprehensibility." (Final Award at 34, 37–38 (quoting *Philip Morris*, 549 U.S. at 354, 127 S.Ct. 1057).) But the contrary is true. Masimo's brief expressly acknowledged *Philip Morris's* holding that "harm to nonparties may be considered in determining reprehensibility." (Masimo Punitive Damages Br. at 19 (citing *Philip Morris*, 549 U.S. at 354, 127 S.Ct. 1057).)

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[11] The Court acknowledges that presiding over a lengthy arbitration only to be potentially precluded from issuing an award because of a judgment in a parallel proceeding would likely engender frustration. Even so, a final judgment in the *Qui Tam* Action came down while the arbitration was still pending. The Arbitrator was duty-bound to evaluate Masimo's collateral estoppel argument, and, in any event, to not punish Masimo for making the argument in the first instance.

Nor did Masimo's brief "outright misstate[ ] the law" by then arguing that *Philip Morris* was distinguishable. Masimo argued that *Philip Morris* was distinguishable because in that case the conduct that harmed the plaintiff was identical to the conduct that harmed the relevant nonparties.[12] Masimo contended that potential harm to patients from the use of its devices was too dissimilar and tangential to the conduct that harmed the Plaintiffs—intolerable working conditions resulting in wrongful termination—to be a basis for imposing punitive damages. (*See id.* at 18–19.) Accordingly, Masimo argued that *State Farm* was the more relevant authority because it addressed the issue of whether *dissimilar* conduct could be used to justify punitive damages, finding that it could not. (*See id.*); *State Farm*, 538 U.S. at 422, 123 S.Ct. 1513 ("A defendant's dissimilar acts, independent from the acts upon which liability was premised, may not serve as the basis for punitive damages.").[13]

It is the attorney's right, even duty, to zealously advocate on behalf of his client. *See* Model Rules of

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[12] In *Philip Morris*, the plaintiff was a smoker who died of lung cancer from cigarettes made by the tobacco company found to have lied about the dangers of smoking, and the non-parties were other smokers in the state who relied on the tobacco company's representations and suffered smoking-related diseases. 549 U.S. at 349–50, 127 S.Ct. 1057.

[13] Masimo further argued that imposing punitive damages for dissimilar nonparty harm was especially inappropriate in this case given that the exhaustive evidence presented in the arbitration revealed only a single instance in which a patient was arguably harmed because of an inaccurate hemoglobin reading from a Masimo device. (*See* Masimo Punitive Damages Br. at 22–24; Final Award at 38.)

Prof'l Conduct R. 1.3 cmt. (2013) ("A lawyer must [ ] act with ... zeal in advocacy upon the client's behalf."). The punitive damages brief submitted by Masimo's counsel did not cross the line of reasonably zealous advocacy, and it certainly did not "outright misstate[ ] the law."

IV. CONCLUSION

Arbitration is intended to be a quick and efficient mechanism of dispute resolution, and it is a rare occasion when an arbitral award warrants setting aside. Unfortunately, this case is one of those rare occasions. By deciding Masimo's disqualification challenge himself, and then imposing punitive damages on Masimo for making the challenge and for other reasonable acts of advocacy by its attorneys, the Arbitrator demonstrated evident partiality that undermined the integrity of the award and the entire proceeding. The Arbitrator's award is VACATED.[14]

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[14] The parties shall appear before the Court for a status conference on April 29, 2014 at 9:00 a.m. to address further proceedings in this case.

JAMS ARBITRATION NO. 1200045317

RUHE, MICHAEL and
CATALA, VICENTE,
Claimants,
and
MASIMO CORPORATION,
Respondent.

FINAL AWARD

1. Introduction. This arbitration presents for resolution the claims of two former sales representatives or "territory managers" (TMs), claimants Michael Ruhe and Vicente Catala, against their former employer, respondent Masimo Corporation. Claimants contend, in summary, that they were forced as a condition of their employment to sell medical devices produced by Respondent which Respondent knew to be unreliable and inaccurate, and that the working conditions eventually grew so intolerable as to force them to resign. The claims are further detailed below.

Claimants originally asserted their claims by a complaint filed in the United States District Court, Central District of California, on May 13, 2011. On September 16th of that year the court ordered the case into the present arbitration, citing the clauses in Claimants' employment agreements discussed below. On September 21, 2011 Claimants commenced this arbitration.

Claimants also filed and pursued a *qui tam* case in the District Court, alleging that Respondent had submitted fraudulent requests for payment to the Government. This case is further discussed below as relevant to the arbitration.

After a continuance, a plenary hearing in the arbitration was had February 11-15 and 18-23, 2013, Claimants appearing by their counsel Kathryn Dickson, Esq., and Scott Bonagofsky, Esq., and Respondents by their counsel Mark Palin, Esq., and Elena Baca, Esq. Testimony was taken both live and by deposition from numerous witnesses, and extensive documentary evidence was received. After conclusion of the evidentiary portion of the plenary hearing, extensive post-hearing briefs were submitted, the last of these on June 3, 2013, followed by submission of various additional motions and notices re new cases.

Oral arguments were heard on July 11, 2013. At the conclusion of the arguments the Arbitrator advised that in light of the volume of evidence and other commitments, completion of the interim award might require 60 days or more.

ln late September the Arbitrator advised counsel that the award was nearly complete.

On October 3rd, Respondent provided a copy of the U. S. District Court's summary judgment order in the related *qui tam* case filed by Claimants. Respondent offered to brief the impact of this decision upon the arbitration. As there appeared to be overlap between the summary judgment order and the issues presented in the arbitration, the Arbitrator agreed that briefing was necessary, and ordered counsel to agree on a schedule. Counsel so agreed, and the last supplemental brief was submitted October 21, 2013. The Arbitrator

ultimately determined that the *qui tam* summary judgment order should have no impact on the arbitration, for reasons developed in detail in the Interim Award, and recapitulated below.

An Interim Award was rendered October 28, 2014. The Interim Award found in favor of Claimants on their claims for constructive termination, but rejected their claims for retaliation under Dodd Frank and California Labor Code § 1102, and also their claim under the UCL for an injunction. The Interim Award further included a "predicate finding" that Respondent was guilty of malice, oppression, or fraud; hence, an award of punitive damages was called for. The Interim Award further directed the parties to brief whether Claimants were entitled to recover attorneys' fees, and if so, the appropriate amount of fees. The parties were directed to agree on a schedule for briefing and hearing the quantum of punitive damages and the attorneys' fees issues. An order eventually was entered setting January 10, 2014, as the date for hearing on these issues.

On November 11, 2013, Respondent, in a letter by its co-counsel Mark Palin, asked the Arbitrator to stay the arbitration to permit an additional validation study to be done on the Pronto devices. The Arbitrator rejected this request, on the ground that it sought to relitigate the merits of the case, previously decided after a two-week plenary hearing.

Thereafter, on the evening of January 8, some 36 hours before the hearing set for 10 AM on January 10, 2014, Respondent, in another letter by Mr. Palin, requested the Arbitrator to withdraw from the case. The Arbitrator's January 9th order denying the

request explains the request and the basis for denying it:

> [Respondent's letter requesting withdrawal] ... cites two alleged failures to disclose information in connection with [the Arbitrator's] appointment.
>
> The letter first asserts I should have disclosed that my brother Stephen Neal and his firm, Cooley LLP, represented companies adverse to Masimo in litigation. I was completely unaware of this fact until I received and reviewed Mr. Palin's letter. Nor do I believe I was under any duty to inquire about matters my brother is involved in. California Ethics Standards 9(b) limits the duty to inquire to Immediate Family, Extended Family living in my household, and former spouse. My brother and his law firm fall within none of these categories. Nor is the information, had I known it, sufficient to cause a person to reasonably doubt my ability to be impartial in this case. No advantage could flow to me from disfavoring a company simply because my brother was lawyer for [its] opponent.
>
> [Respondent] also asserts I should have disclosed my former membership for several years many years ago on the Board of Directors of the SIDS Foundation. [Respondent's] letter furnishes no coherent explanation as to how to this information would cause a person reasonably to doubt my impartiality in the present case.
>
> The information upon which this request is based has been available for years, and Masimo could and should have raised these points long ago, and certainly before it received the Interim Award revealing a decision adverse to Masimo.

(In the last several years, the Arbitrator made a decision in favor of Respondent in another employment-related arbitration (*Camp v. Masimo*) as well as a major class decision in favor of another employer-client of Respondent's co-counsel Paul Hastings, after a multiweek trial *Johnson v. Gruma*). Respondent's implication that it would have disqualified the Arbitrator, in the face of these facts, because his brother, in some unrelated litigation unknown to the Arbitrator, was. adverse to Respondent, is not credible.)

Following rejection of the withdrawal request, the hearing on January 10, 2014, proceeded on schedule, with appearances for Claimants by Ms. Dickson, Ms. Nugent, and Mr. Bonagofsky, and for Respondent by Mr. Palin of Atkinson and Ms. Baca of Paul Hastings with Stephen Berry, Esq., of the same firm, for Respondent.

The following statement of reasons recapitulates the substantive discussion and findings contained in the Interim Award, addresses and resolves the punitive damage quantum and attorneys' fees and cost issues, and frames the Final Award, finally resolving all matters requiring disposition in this case.

2. Statement of the Case

A. ARBITRABILITY. The claims are arbitrable under the "Masimo Arbitration Agreement" entered between each Claimant and Respondent. The agreements are in the Case Anywhere electronic file for this case. They provide, in summary, that binding arbitration "shall be the sole means of resolving all disputes between the Employee and the Company, to the fullest extent allowed by law." The claims addressed in this award fall within this description and

are arbitrable. The U.S. District Court entered an order September 16, 2011, compelling arbitration under these agreements.

B. PRELIMINARY STATEMENT. This is a challenging case. The allegations are very serious. A publicly-owned company manufacturing medical devices is charged with knowingly and deliberately selling to physicians and clinics blood measuring devices that were not reliable or accurate. Claimants, former sales representatives for the company, charge that physicians and clinicians and the Food and Drug Administration were deliberately deceived, and that the lives of patients were endangered. Claimants allege that the company pressured them and other sales representatives to continue selling the devices, knowing them to be unreliable and dangerous. Claimants ask the Arbitrator to award punitive damages.

The case is highly fact-intensive. Numerous witnesses testified over two weeks of live hearings, and additional witnesses testified by deposition. More than 1,000 documentary exhibits were marked, drawn from hundreds of thousands of pages of documents. Claimants' opening post-hearing brief numbered 120 pages, supplemented by many, many additional pages contained in 8 appendices collecting information on various issues. Respondents' brief in opposition numbered 85 pages, and Claimants' reply, 75 pages. Highly complex and data-laden spreadsheets comprise part of the evidentiary record. Three hours of oral closing argument were heard.

The Arbitrator will not attempt, in the discussion of evidence that follows, to minutely digest and recapitulate all the evidence presented by the two

sides. There is too much of it. A reasoned award is not a digest, but rather should be a lucid explanation of the bases for decision.

In the following sections the Arbitrator will, first, set the scene for the dispute with relevant background information; second, summarize the Claimants' evidence; third, summarize the Respondent's responding evidence; fourth, address and dispose of several threshold questions; fifth, analyze the legal theories advanced by Claimants and the responses to each; and sixth, decide the claims.

C. FACTUAL BACKGROUND

1) Basic Information. Respondent is headquartered in Irvine, California, and is a developer and manufacturer of medical devices. The devices involved in this case are noninvasive devices to measure medical characteristics of the blood. Joseph Kiani is Respondent's president and cofounder. There is a related privately held corporation, formerly known as Masimo Labs, now called Ciracor, also headed by Mr. Kiani.

Respondent's original and leading blood-related product line is noninvasive pulse oximeters, which measure the oxygen saturation or amount of oxygen in the blood. These devices function by shining rays of visible or infrared light through the patient's finger and reading changes in the color of the blood, which varies with the amount of oxygen the blood carries.

The products primarily in issue in this case are the "Pronto" and the "Pronto 7." These devices are designed to add to the oxygen-measuring capabilities of Respondent's other products the ability to measure the amount of hemoglobin in the blood. Hemoglobin is a substance that enables the blood to carry oxygen

throughout the body. The Pronto and Pronto 7 are similar in size and in general appearance to a television remote control, with a screen displaying data, plus a wire and a clothespin-like sensor that clips on the patient's finger.

Historically, blood hemoglobin has been tested by drawing blood with a needle from a vein or artery, usually in the elbow, followed by submission of the drawn blood to a laboratory at a location remote from doctor's office or clinic, for analysis using a machine there. Point-of-care devices kept in the clinic or physician offices also are in wide use. The HemoCue is a leading device in this category. It tests blood drawn by a finger prick at the point of care.

Respondent's Pronto devices are potentially attractive to doctors, hospitals, clinics, and patients, primarily because they are "noninvasive", that is, they do not require a painful blood draw or finger prick, and also because of the greater speed with which a reading is obtained (hence the name "Pronto.")

Permission to market medical devices must be obtained from the federal Food and Drug Administration (FDA). There are two avenues to obtain such permission, one leading to "approval" and the other leading to "clearance." The process for obtaining "approval" is plenary, requires filing of a PMA [Pre-Market Application], and involves several years, submission of extensive data regarding clinical trials, and considerable expense. "Clearance" is a faster and more streamlined process in which a device is "cleared" over a period on the order of 90 days. Clearance is obtained by submitting a "Form 510k" to the FDA. The clearance process may be used only where the technology of the device submitted for

clearance has previously been approved by the FDA in a "predicate device" which employs the same core technology.

Medical devices cannot be sold without FDA clearance or approval. Further, FDA regulations limit the representations that the seller can make concerning a device and its accuracy. These "labeling" requirements apply not only to any statements made on product labels, but comprehensively to representations made in advertisements and brochures, operating manuals, warranties etc. A device may not properly be represented to be FDA "approved" if it has only been "cleared."

Respondent applied for and obtained clearance for the Pronto based on a predicate device called the "Radical 7." This device, intended primarily for hospital use, continuously monitored oxygen levels. It consisted of a base unit about the size of a shoebox, with a detachable small handheld readout unit. The detachable handheld component was designed to be removed from the base unit to accompany a patient when transferred between hospital rooms. The handheld unit would then be plugged into the base unit in the destination room.

All three of the devices, Radical 7, Pronto, and Pronto 7, use Respondent's "Mx" board and Respondent's "signal extraction technology" (SET). All three devices use a sensor somewhat similar to a clothes pin which is clipped around the end of the patient's finger. Light emitters on one arm of the clothes pin project light through the finger; receptors on the other arm read the light. The readings are transmitted to a computer. The SET technology filters out irrelevant signal data from the light wave readings

and extracts the data necessary to measure oxygen and hemoglobin. The computer uses an algorithm (a step-by-step process for computer calculations) to convert the wave data into digital numerical readings of oxygen saturation and total hemoglobin levels.

The Radical 7 device displays a continuous wave reading, while the Pronto devices display a single "spotcheck" reading. But, the Radical 7, like the Pronto, takes spot readings at regular time intervals, which then are presented in a moving average on the display.

2) Cast of Characters. Claimant Ruhe has worked in sales since 1989, and medical sales since 2004. He had prior experience with new technology launches in the dentistry field. He began at Respondent in December 2008. Claimant Catala had 15 years sales experience before going to work for Respondent in March 2009. His past experience included 11.5 years at Merck selling vaccines and injectable medicines. Both Claimants received highly favorable performance reviews from their immediate supervisor Mr. Birkle (see below). As of June 2010 both were among only six Masimo sales representatives, or TMs, nationwide who were at or above their sales targets.

Respondent's President and founder is Joseph Kiani. Mohammed Diab is Respondent's cofounder and chief scientist. Direct reports to President Kiani during the relevant time period included: Anand Sampath, Executive Vice President Engineering; Rick Fishel, President, Worldwide OEM Business and Business Development; Paul Janssen, Executive Vice President Marketing; Gary Marston, Director of Strategic Marketing. Respondent's Vice President for the Physicians Market, Kevin Hammond, reported

directly to Mr. Fishel. Reporting to Mr. Hammond were John Birkle, Mike Smits, Ric Duncan, and Todd Steinhoff, respectively the Western, Central, Eastern, and Southern Regional Managers for the physician market.

The frontline sales personnel, called "Territory Managers" or "TMs", reported to the Regional Managers for the physician market. Claimants reported to Mr. Birkle. Claimant Ruhe was assigned to the San Diego territory, Claimant Catala to the greater Los Angeles territory. Other Territory Managers included Corkie Matson, Kip Horton, Kristine Serwitz, Marianne Ionnatta, and Heidi Hawkins (all but Horton have resigned).

Jay Hachey is Respondent's Corporate Product Manager. Mark Holody is Director of Clinical Research. Marguerite Thompson is Manager of Regulatory Affairs. Marianne Kivinsky is Compliance Officer. Marcelo Lamego is Respondent's Chief Technical Officer.

Bill Lepowsky is Claimant's statistics expert. Anne Graham is Respondent's FDA expert.

3) The Specification. It is undisputed that Respondent claimed the Pronto and Pronto 7 were accurate in measuring hemoglobin levels to within the following specification: plus or minus one gram of hemoglobin per deciliter (+/- 1 g/dL) at the first standard deviation, +/-2 g/dL at the second standard deviation, and +/- 3 g/dL at the third standard deviation. A "standard deviation" is a statistical term describing the percentage of a statistical population which falls within a range: 68% within the first standard deviation, 95% within the second, 99% within the third. The Average Root Mean Square (ARMS),

sometimes used as a measure of accuracy, only addresses accuracy at the first standard deviation, i.e., for 68% of the statistical population.

President Kiani testified that Respondent expects physicians and other device users to rely on this "specification" or "spec."

Respondent claimed in a variety of written materials that the Pronto and Pronto 7 met the above-described "specification."

Respondent's sales marketing brochure [Ex. 327] (sometimes referred to by sales personnel as a "slick") was supposed to be used with all customers, and left with them at the end of a sales visit. The brochure stated that the Pronto was accurate to within ".95 g/dL standard deviation" compared to a laboratory measurement. It further indicated that for hemoglobin levels above 12 g/dL, 99% of readings were within 2 g/dL of the lab standard, and for levels below 12g/dL, 94% of readings were within 2 g/dL. The information in the immediately preceding sentence essentially revealed the claims for second and third deviations. (The brochure did not disclose that the specification was based on the Radical 7, a continuous monitoring device, not the Pronto, a spotcheck device).

The Technical Bulletins prepared by Respondent for the Pronto [Ex. 274] give the ".95 g/dL" figure at 1 SD but does not address the second or third standard deviations. The Bulletin for the Pronto 7 [Ex. 54, p. 4] shows .91 g/dL at 1 SD, and furnishes no data for second or third standard deviations.

Accuracy claims in the Operator Manuals for Pronto [Ex. 325] and Pronto 7 [Ex. 409] are closely similar to those in the brochure, quoted above.

In Service Checklists, which reps were supposed to use at time of delivery and installation of devices, were claimed FDA-stated accuracy of "+/- 1 g/dL." The Checklists did not mention that this was at the first standard deviation, nor did it explain the claimed accuracy at the second and third standard deviations.

As explained by Claimants' statistical expert, Lepowski, accurate information about performance at the second and third standard deviations is material and important. The first standard deviation figure (ARMS) applies only to 68% of the patient population; a doctor needs to know the possible magnitude of inaccuracy for the remaining 32% of the population, and indeed also for the 5% or so of the population who fall within the third standard deviation.

Warranties for the devices [Ex. 1169] confirm that the devices conform to the applicable specifications.

4) Summary Timeline. The following short timeline is helpful for understanding the sequence of events:

December 20, 2007—Respondent files 510k application for Radical 7.

May 18, 2008—FDA grants clearance for Radical 7.

December 2008—Claimant Michael Ruhe hired.

July 16, 2008—Respondent submits 510k for Pronto (formerly known as Rad Check).

October 10, 2008—FDA grants clearance for Pronto.

January 1, 2009—Pronto first sold—"LMR."

March 2009—Claimant Vincente Catala hired.

July 1, 2009—Pronto taken off market—recalled.

July 1, 2009—March 5, 2010—TMs sell Rad 7s to hospitals.

July 31, 2009—510k for Pronto 7 without oxygen submitted.

December 28, 2009—510k, Pronto 7 without oxygen, rejected.

February 5, 2010—510k for Pronto 7 resubmitted, with oxygen.

March 5, 2010—Pronto back on the market.

June 23, 2010—Pronto 7 with oxygen, cleared by FDA.

October 22, 2010—both Claimants resign.

November 3, 2010—Claimants meet with Respondent's Compliance Officer Kivinsky.

?????????--Claimants interviewed by U.S. Attorney

December 21, 2010—Pronto 7 withdrawn (recalled?)

May 11, 2011--FDA investigation exonerates Respondent?

D. CLAIMANTS' EVIDENCE. As a preliminary observation, Claimants have supported their factual assertions with extensive citations to testimony and to the documentary record. Their briefs develop the evidence in exhaustive detail, supplemented by extensive additional detail in several of the appendices to their opening brief.

Claimants offered detailed evidence that both the Pronto and Pronto 7 devices from their first introduction into the market consistently failed to provide accurate reliable readings. The evidence includes testimony from the Claimants, and from other TMs, and emails, documenting numerous instances where test results on patients and in doctors' offices and clinics were widely inconsistent from reading to

reading, or inconsistent with readings obtained from reliable laboratory test results, or inconsistent with known parameters expected for particular patients, and/or inconsistent with the specification.

For example, Claimant Ruhe described a visit with Doctors Neerja and Alexander soon after the Pronto went on the market in January 2009. The device produced "significant variations in back to back readings among several doctors." Birkle reported the incident to Product Manager Jay Hachey in an email [Ex. 755]. The doctors did not buy.

At a training session in March 2009, Catala's hemoglobin was tested with Pronto and a venous blood draw; there was a 4 g/dL disparity. Other TMs Iannotta and Tatum were tested repeatedly, Catala testified, because their Pronto results were inconsistent. Marston commented that Catala's results suggested he was a "freak of nature."

The record includes the names of numerous complaining doctors, patients and clinics, and the dates and particulars of the incidents. Claimants' Appendix C to its opening post-hearing brief lists 165 separate device accuracy complaints by TMs and others, identifying in detail the names of complaining parties, the date, the particulars of the complaint, and the substantiating documentation.

A series of site studies and evaluations conducted by TMs and others confirmed that the devices were materially less accurate than claimed by the device specifications. The results are gathered in an extensive spreadsheet [Ex. 605]. Examples of the studies and the results showing failure of the devices to meet the 1.0 ARMS specification (1g/dL at first standard deviation) are collected at pp. 25-30, Claimant's opening post-trial

brief. Numerous of these showed "out of spec" results. The spreadsheet and brief furnish names, dates, and particulars. A large study done at Vanguard clinic showed an ARMS of 1.438—vs. the 1.0 claimed by the specification. Tests on the Pronto with the Rev E Sensor, reflected in Ex. 860, show an ARMS of 1.54. A study of Pronto with Rev E at Clinica Medica based on 43 subjects shows an ARMS of 1.5. A test at Peter Park's Clinic in Los Angeles showed eight out of ten subjects more than 1 gram off spec. At Spectrum Women's Health, Catala tested 12 patients; 10 out of 12 were more than one gram off lab value, and some were 3 or 4 grams off. A study by Respondent's Corporate Product Manager Jay Hachey, involving 795 readings on 53 subjects, showed more than 20% were more than 2g/dL different from the blood draw result—vs. the spec claim that 95% should be less than 2 grams different. Numerous other studies are detailed in Claimants' brief and evidence and further show the devices' inaccuracy.

The foregoing results were obtained in studies controlled by Respondents. Claimants offered credible and detailed evidence that Respondent refused to authorize genuinely independent studies in which a neutral third party could compare device performance to the specification. Dr. Holody, Director of Clinical Research, testified that "this is not how Respondent operates," and that in particular, in 2010, Respondent was not "supporting" independent studies of the Pronto and Pronto 7.

Claimants offered detailed and extensive evidence that Respondent's managers, up to and including President Kiani, were aware of the extent of device inaccuracies. [Opening brief, 30-38]. Some 43 separate

bullet points in the referenced section of Claimants' brief set out in detail, with names, dates, particulars, and citations to supporting exhibits and transcript, the evidence showing knowledge of the device failings at the highest levels of the company. A handful of examples from this catalogue of evidence illustrate:

- Executive VP Fishel admitted that Pronto had performance issues pretty quickly when taken to the field [transcript cites at Claimants' opening brief p. 30];
- Executive VP Jansen had the impression the market was not receptive to the Pronto; evaluations of its accuracy were not positive; Jansen's email to Joe Kiani and Rick Fishel dated April 3, 2009, attaches data showing 3 out of 7 hemoglobin readings at Carolina Kidney greater 2 g/dl off the lab value [*Id.*, 31];
- CEO Kiani acknowledged that the Pronto in 2009 was not working to the company's or its customers' satisfaction [33];
- Gary Marston, Director of Strategic Marketing, acknowledged in deposition that management was concerned about device performance and whether or not it was working in spec [33];
- Jay Hachey, Product Manager for the Pronto and Pronto 7, rode along with Catala in April 2010 to replace a nonfunctioning device. They tested a woman and obtained a very high reading, uncorroborated by the patient's symptoms. When Catala asked Hachey after the meeting "what are we going to do about these inaccuracies," Hachey responded by saying the Pronto was "piece of shit." [33]

- Territory Manager Duncan testified that all his TMs had serious accuracy concerns about the Prontos [34].

Managers in confidential one-on-one exchanges with TMs said that the devices were "pieces of crap" (Kevin Hammond) or "pieces of shit" Jay Hachey) or should not be taken out of the box during sales presentations (Mike Smits), or needed "more smoke and mirrors" to be successfully sold (Hammond). Hachey, in a ride-along with Ruhe for evaluation of Pronto 7 at Scripps, said, according to Ruhe, "I don't believe we should be selling so many of these devices into a hospital that's going to be used as a diagnostic ... it's a potentially hazardous situation." Hachey admitted this conversation in deposition.

And yet, as Claimants point out in another detailed recitation *[Id.*, 39-43], Respondent's executives at trial steadfastly denied that the devices were *ever* out of spec. President Kiani testified at the hearing that the Pronto never failed to perform as specified, and that Executive VP of Engineering Sampath so assured him. Birkle, reviewing test results obtained by Claimant Ruhe at Scripps, showing 6 of 11 readings more than 1 g/dL off the lab value, insisted that the device was performing within specification. Claimants provide at length and in detail examples of similar testimony by Mr. Sampath, Executive VP Engineering, Mr. Hammond, Mr. Marston, Mr. Hachey, Mr. Abe Kiani, Mr. Jansen. Jansen testified that he "very strongly told his sales force to go out to doctors and tell them the Pronto always met its accuracy spec."

Respondent experienced a very high rate of returns of the devices. Regional Sales Manager Duncan testified that virtually all the Pronto 7s sold in 2010

were returned. Horton sold 50-60 Prontos in 2009 and 2010, and estimated that 30% were returned by doctors complaining of accuracy and operational problems.

It is undisputed that Respondent withdrew the Pronto from the market in July 2009. Claimants contended and cited contemporaneous documentary proof that Respondent initially ordered recall of *all* units previously sold then modified these instructions to request TMs to leave a few units in the field. Claimant urges that this modification was intended to position Respondent to avoid having to tell the FDA that it had recalled the device. There is no evidence that Respondent told the FDA there had been a recall or withdrawal.

It is further undisputed that Respondent withdrew the Pronto 7 from the market in December 2010.

Claimants further offered substantial evidence that managers withheld from TMs, other managers, customers, and investors, information about device inaccuracies. [*Id.*, 42-48].

Claimants offered persuasive detailed evidence that the Technical Bulletins prepared by Respondent to describe performance of the devices were inaccurate and misleading, and that Respondent violated FDA labeling requirements by issuing brochures, warranties, and marketing materials which misrepresented the devices' accuracy. [*Id.*, 48-57]. An extensive list of the claimed labeling violations is contained in Appendix E to Claimants' opening brief.

Claimants contended that Respondent misled the FDA into clearing the Pronto 7 device. The Radical 7, described above, was the predicate device based on which Respondents applied for 510k clearance of the Pronto. Measurement of oxygen (SpO2) was the

primary function of the Rad 7. Rad 7 also included a hemoglobin capability, but the FDA understood this was not intended for diagnostic use [Ex. 690, minutes of meeting with FDA examiner Patel, stating the Masimo hemoglobin devices not intended for diagnostic use.]

Respondent applied for clearance of the Pronto based on the Rad 7 as the predicate device. The Rad 7 was an appropriate predicate device for the Pronto if the latter device was intended to function primarily as a SpO2 device, with ancillary non-diagnostic hemoglobin capability. But Patel's minutes show that Rad 7 was not a proper predicate for a new device primarily intended for diagnostic hemoglobin tests. When Respondent initially applied for 510k clearance of the Pronto 7, it had no SpO2 capability. The FDA rejected the application [Ex. 679], stating that the device had a "new indication for noninvasive measurement of hemoglobin concentration. This measure alone may lead to clinical decisions that would alter the diagnostic affect, impacting safety and effectiveness, and is therefore a new intended use.... Therefore this device is classified by statute into class III (Premarket Approval) and is required...to have an approved Premarket Approval Application before it can be legally marketed."

Based on this conclusion, FDA rejected the application for clearance of the Pronto 7. In a follow-up meeting, described in meeting minutes, FDA advised Respondent as follows:

> ARDB stated that healthcare providers may use a medical product as they deem in the best interest of their patients consistent with the practice of medicine. However, hemoglobin

> measurement in the context of multiparameter oximeter monitor was not cleared to the same standards of an independent laboratory diagnostic test. ARDB further indicated that hemoglobin assessment by oximetry should not be promoted as a substitute for a laboratory diagnostic test.
>
> ARDB continued that they did not wish to discourage innovative development of a noninvasive alternative to a laboratory diagnostic test. ARDB encouraged Massimo to submit a pre-IDE package if they intend to pursue marketing of a device with its primary intended use to noninvasively measure hemoglobin. [Ex. 774]

In these communications, if the Arbitrator understands them correctly, the FDA told Respondent that it could not pursue marketing of a device whose primary purpose was noninvasive diagnostic measurement of hemoglobin, without first submitting a pre-IDE (Investigational Device Exemption) package. Respondent's expert Graham described IDE as a process for determining the correct regulatory procedure ("pathway") for a device. She conceded "under the circumstances we are discussing, it would have made sense for this device—it would clarify the regulatory process."

Claimants contend, and the preponderant evidence shows, that Respondent flouted these directives from the FDA. It filed neither a pre-IDE nor a PMA. Instead, it added a cosmetic SpO2 capability to the Pronto 7, configured the device so the SpO2 function was concealed in default position, and then proceeded

to market the Pronto 7 with the primary purpose as a diagnostic hemoglobin device.

Claimants again cite extensive evidence in support of their contentions, this time at pp 66-69 of the opening post arbitration brief. President Kiani and Director of Physician Sales Hammond directly admitted that primary focus of marketing the devices was on hemoglobin. Birkle wrote to a customer claiming the Pronto 7 facilitates "timely anemia diagnosis and treatment." The Technical Bulletin for the Pronto 7 contains an accuracy specification for the device's hemoglobin function but not its SpO2 function [Ex. 274). A power point TMs were instructed to use with customers [Ex. 656] describes "Pronto 7, a new solution for hemoglobin testing, and states "facilitates timely diagnosis and treatment decisions." A Pronto 7 reimbursement sheet TMs were told to give to customers [Ex. 706, 33] instructs they should submit claims for Pronto 7 use to Medicare; a footnote 1 states that diagnostic tests are reimbursable but screening tests are not. Additional evidence is cited in the brief pages noted.

The SpO2 function of the Pronto 7, Claimants say, had its own serious accuracy problems, including a large number of 100% saturation readings. Internal studies by Hachey confirmed problems. One study showed 76% of the participants at 100% oxygen saturation. [Ex. 240] In an email to Jansen, Fishel [Ex. 372] noted the "primary focus" of the Pronto 7 was hemoglobin, and related that customers concerned about the accuracy of the SpO2 function also would have doubts about the hemoglobin function. He wondered if Respondent could create a display configuration where the customer elected not to

display the SpO2 function. Jansen responded that he thought the strategy risky. But, Respondent elected to do it, and TM demo units were updated so the SpO2 function did not show during sales demonstrations.

Claimants elicited evidence that Respondent was hurrying to be the first to market a noninvasive hemoglobin measuring device. An Israeli firm, Orsense, was also working to develop and market such a device. When former TM Corkie Mattson suggested at a meeting with President Kiani that it was more important to have the best device than the first device to market, Kiani disagreed. Emails between the President and his younger brother confirm the inference that Respondent was so motivated.

Claimants cited the testimony of Respondent's FDA expert, Ann Graham, that the FDA "did not clear the [Pronto] devices for [diagnostic or therapeutic use]." Claimants further offered proof that Respondent nonetheless advertised and marketed the devices as suitable for diagnosis. For example, Mr. Birkle's email to a Dr. Hanna [Ex. 755] claimed the Pronto 7 "facilitates timely anemia diagnosis and treatment." The email emphasized the device's noninvasive character, avoiding "painful needle sticks," and also its Medicare reimbursability. A training document used with TMs [Ex. 551, p. 3] emphasized the noninvasive nature of the device, and urged reps to tell the customers the devices were "FDA approved as substantially equivalent to a lab oximeter."

Respondent offered to accept competitors' (i.e. HemoCue) point-of-care devices in trade-in for Respondent's devices, potentially leaving the Pronto 7s as the sole hemoglobin test device in doctors' offices or clinics, with attendant likelihood of use of the devices

for diagnosis, a use for which they had not been cleared or approved.

Claimants provided extensive evidence that device inaccuracies could threaten patient safety, particularly in clinics where certain medications were prescribed based on device readings. Inaccurate readings could lead to administration of potentially toxic medications such as Procrit to patients who did not truly need them, or result in withholding medications from patients truly in need. This evidence is recited in detail in Claimants' opening post-trial brief, pp. 71-76.

Substantial evidence was offered that Respondent met the TMs' concerns about continuing to sell flawed devices with pressure and insistence that the TMs continue their efforts to sell the devices. A particularly striking example of this was advice by Claimants' regional sales manager, John Birkle, to resigned TM Corkie Mattson, that "you were hired to sell the device, and even if it were to catch on fire, you have to find some way to sell it because that's our job." Matson testified to this statement, and Birkle admitted "he might have said it to TMs." Ruhe testified to hearing a similar comment from Birkle. Kristine Serwitz testified Birkle suggested to her that she bribe a distributor to buy a Pronto. She declined. Heidi Hawkins testified about a trade show where she and Birkle observed that the devices didn't work; Birkle said "sell it anyway." Birkle, in response to Claimant Ruhe's misgivings, told him "he better find a way to sell this thing," or he would find someone who could.

Both Claimants were placed on "GAP" remedial performance plans in mid-2010 because their sales of devices had fallen off drastically.

Claimants testified that they resigned in October 2010 because they could not, in good conscience, continue to hold out to their customers as valuable and reliable the devices they were required to sell in their capacities as TMs. Their joint letter of resignation [Ex. 1] sets forth in considerable detail their reasons for resigning. The reasons given are essentially those developed at length in the evidence at the hearing, as summarized herein. The Pronto devices were not accurate within 1 g/dL 68% of the time, as specified. "Outliers of 3 g/dL occur more than 3-5% of the time." TMs have come to call the Pronto 7 the "Problem 7." Claimants were concerned that patients would be harmed. One physician had reported that a patient indicated as having normal hemoglobin by Pronto 7 in fact was seriously anemic and required a blood transfusion. Despite these problems, their supervisor, Regional Sales Manager Birkle, was telling them their job was to sell the devices "no matter what," even if they "catch fire."

Each of the Claimants was earning on the order of $140,000 annually, income given up when he resigned. At the time of resignation, Claimant Ruhe was poised to close a substantial sale of devices to a nephrology clinic, a transaction that would have yielded a large commission for him.

Claimants offered evidence that, of the total of 18 TMs selling the devices at the start of the campaign in 2009, 14 eventually resigned or were fired. Claimants elicited live testimony from three of these, Kristine Serwitz, Corkie Mattson, and Marianne Iannatto, to the effect that they resigned because they found it intolerable to continue to sell devices they believed to be defective and dangerous. Their resignation letters

and emails confirm this evidence. [Exs. 398, 468, 683, 1072] Claimants further offered evidence that former Pronto TMs Borden, Blackmon, Erickson, Holden, McAuliffe, Fabrega, Tatum, and Denney, all of whom resigned, had each expressed concerns about the accuracy of the devices [see Claimant's opening post-trial brief, pp. 77-81]

Claimants offered evidence that Respondent was on notice that it was creating intolerable working conditions by insisting that sales personnel continue to enthusiastically sell defective devices [Claimants' opening post-trial brief, page 88, et seq.] Among other notice, Respondents received a detailed resignation Jetter from Ms. Serwitz when she resigned [Ex. 398] relating her own and other TMs concerns with the disparity between the devices' specification and its real world accuracy. She noted the potential for patient harm, and explained that she was resigning because not comfortable with selling the devices. Respondent countered with a Jetter from Assistant General Counsel Ms. Kivinsky stating. "We have not found anything confirming your statements about false claims of accuracy of the devices, improper data collection, or manipulation of data to support false accuracy claims." [Ex. 399]

Shortly after Claimants resigned they met with Ms. Kivinsky, to whom they proposed that Respondent consent to an investigation by an independent neutral third-party—a proposal Respondent turned down. Claimants also were interviewed soon after resignation for a full day by a representative of the United States attorneys' office.

Claimants offered expert testimony of Phillip Allman regarding their economic damages. Despite

the recession, both obtained satisfactory replacement employment fairly quickly, Ruhe after about four months, Catala, after about two months. Allman testified that Catala's economic damages were $97,613 and Ruhe's, $112,443 [Exs. 681, 682]. These calculations properly accounted for mitigation from earnings from Claimants' new jobs.

Both Claimants testified to anxiety, humiliation and distress resulting from ongoing device failures in the field and the resultant fear of doctor anger and patient injury. Each reported a period of psychiatric consultation and medication; no expert was called to testify about this treatment.

E. RESPONDENT'S EVIDENCE. In the face of the foregoing evidence, Respondents steadfastly maintained they did no wrong. Thus, in closing argument Respondent's counsel said "Masimo has the right motives and is always looking to do the right thing.... What does Masimo do time and time again? The right thing."

Despite this contention, Respondent did not challenge much of the extensive evidence offered by Claimants and summarized above.

Respondent did not dispute that it ultimately recalled or withdrew both Pronto and Pronto 7 devices from the market. This conduct is unequivocally an admission that the products were not ready for the market, as Claimants contend they were not.

Respondent does not attempt to show that Claimants' evidence of numerous device malfunctions and physician and clinician complaints is false or fabricated. For example, Respondent did not call any of the doctors or others whose complaints of problems with the devices are recorded in the documents and

testimony, and seek to elicit testimony that they did not make the complaints alleged by Claimants.

Respondent does not deny that Israeli competitor Orsense was close to marketing a competing device, or that Respondent strongly desired to "beat Orsense to the market" with a noninvasive hemoglobin device.

Respondent does not attempt to disprove that managers disparaged the devices, on occasion calling them "pieces of crap" and "pieces of shit," telling TMs not to take the devices out of the bag on sales calls.

Respondent does not attempt to controvert the evidence of high turnover among TMs, and does not dispute that several TMs other than Claimants resigned, like Claimants, professing they could not in good conscience continue to sell the devices.

Respondent does not attempt to challenge or controvert Claimant's evidence of very high levels of device returns. Respondent does not attempt to disprove Claimants' evidence that Respondent blocked real independent testing of the devices.

Respondent offered no evidence to undermine Claimants' evidence that false negative or positive hemoglobin readings can lead to dangerous treatment errors, with, on the one hand, potentially toxic medicine prescribed to patients who should not receive it, and on the other hand, medicine denied to patients who need it.

Respondent does not controvert much of Claimants' narrative concerning the initial rejection of the 510k for the Pronto 7, and the resubmission with SpO2 added. Respondent does not controvert Claimants' evidence that the Pronto 7 specification did not state an accuracy standard for SpO2, nor the evidence of wildly inaccurate SpO2 readings, nor the evidence that TM

Pronto 7s were configured after resubmission and approval of the 510k so as not to display SpO2 readings during sales calls.

Respondent called no doctor or clinician or other customers to testify that the devices performed well, or satisfactorily, nor did they call any TM or workplace expert to testify that working conditions were tolerable or acceptable.

Respondent points to a letter received from the FDA dated May 11, 2011, following an inspection at the company's premises in February 2011. [Ex. 1155] (Claimants' objection to this letter is further discussed below.) The inspection was instigated as a result of a complaint received from an unidentified former employee or employees, presumably Claimants or Serwitz. Respondent contends that this letter reflects an FDA determination that Claimants' claims herein are without merit.

Respondent did not call as witnesses any of the FDA investigators who conducted the investigation and signed the letter. No witness testified about or explained the letter. The letter identifies six persons interviewed; of these only one, Yongsam Lee, testified during the plenary arbitration hearing, and he was not examined about the letter. So far as the letter reveals, the investigators interviewed none of the TMs, none of Respondent's marketing people, nor anyone else. The report does not catalogue or address more than perfunctorily the extensive evidence supporting Claimants' core allegations of gross device inaccuracy and unreliability, false representations, customer dissatisfaction, and safety concerns. Nor does it address the evidence described elsewhere herein that

Respondent gamed the FDA clearance process for the Pronto 7.

Respondent called no economic expert to challenge Claimants' computations of economic loss. However, Respondent offered evidence that Claimant Catala lied on his employment application, stating that he was "laid off" by prior employer Merck, when in fact he was fired for suffering a conviction for driving under the influence of alcohol. This admission was obtained in Catala's deposition taken January 10, 2012.

Respondent also offered evidence that Claimants each took company documents when they resigned in October 2010, and that Respondent discovered this December 21, 2011, when the documents were produced in discovery in this arbitration.

Respondent contends it would have fired Catala on discovery of his misrepresentation on his application, and further, would have fired both Claimants upon discovery of the document theft on December 21, 2011. No company policy is cited in support of this claim, but Birkle testified he would have referred this to Human Resources and sought Claimants' termination.

Respondent challenges several key factual propositions central to Claimants' proof.

First, Respondent attacks Claimants' implied argument that the devices should have been reliably accurate when brought to market. Respondent urges that a high rate of device failure and inaccuracy is normal to the introduction of new medical devices, and that it is customary to introduce devices and then learn from their failures in the field. Respondent's counsel in closing argument thus urged:

> Medical devices develop over time. They're not a drug. A drug has molecular properties. It

> goes in your body. The FDA regulates them differently. The FDA says *clinical trials need to match real world use*....
>
> Pulse oximetry, with its light shooting through a finger, that relies on people doing it just right The *FDA expects and knows that clinical [trial] is not going to be the same as real world*. [Tr. 2248] (Arbitrator's emphasis)

A related line of Respondent's proof concerned the so-called "Limited Market Release." Respondent's counsel explained in opening statement:

> Now we're going to look *at how the device goes from the laboratory to the real world*. We're going to hear a term called 'LMR,' which stands for limited market release. In an LMR, the product is released on a limited basis, not a full release. *Throughout the entire time [Claimants] worked for [Respondent] the device was always in a limited market release*. It didn't go to full market release until 2012. (Arbitrator's emphasis)

This argument is contradicted by President Kiani's testimony that, with the rerelease of Pronto, the device was in "full market release." Other contradictory evidence is in the record as well. (Claimants' opening brief, p. 9)

Respondent's Post-Hearing Opposition Brief elaborated on this theme:

> [Respondent's] process for introducing a new product involves a Limited Market Release ("LMR".) Only products that have received FDA clearance enter LMR. After receiving

> FDA clearance, rather than a full market release, [Respondent] introduces the product to the market slowly. This allows [Respondent] to obtain feedback on the products from early adopters, and to observe product performance in the real world where conditions vary from the controlled conditions under which the products were tested for FDA clearance." (p. 8)

Thus, Respondent urged, the FDA does not expect initial medical device performance to conform to clinical trial data presented in obtaining FDA clearance or approval. The inaccuracies experienced during Claimants' employ are, according to Respondent, typical of new medical devices, and as expected and allowed by the FDA. There is, according to Respondent, a transition phase in which medical devices undergo a sort of field testing through "limited marketing." Respondent characterizes the purpose of the LMR as "to obtain field and customer feedback regarding product performance and product operation in clinical environments."

But, Respondent cited no regulations, guidelines, reported cases, or other authorities endorsing this "trial in the field" approach to device marketing. Respondent's FDA expert Graham testified that this term has no relevance to the FDA. (Video, 161-162)

In testimony at the hearing, some of Respondent's witnesses ascribed the high rate of device inaccuracies and problems in the field to improper conduct of tests by TMs. They urged that tests were done on fingers or hands that were too cold, or other operator error. At one point management insisted the device should be used with a black bag over it to keep out light—a procedure Respondents soon abandoned.

Respondent sought to blunt the safety concerns expressed by Claimants by urging that doctors were not encouraged to rely on Respondent's devices for diagnosis. Respondent argued that the devices simply provided additional information for doctors to use, in their discretion, to cross-check readings from blood draws or finger pricks:

> What else did we tell people? We also told them it's going to be different than whole draw measurements. We told them that you should go and you should consider everything you see. ... this whole thing about diagnosis, diagnosis we heard from Dr. Kiani. They take pieces of information and they build the puzzle and they make a decision about what they think is happening with the patient ... We do not say, "use our device, Yes or No." We say, here is a piece of information, and you're getting it noninvasively. [Respondent's closing argument, Tr. 2226]

Thus, Respondent argued, accuracy in the initially-released devices was not critical because users were cautioned not to rely on the devices for diagnosis.

Respondent also discusses "Lost Stalled Opportunity Reports" or "LSOR" forms and "1022" forms filled out by TMs. The LSORs were intended to discuss sales issues, and the 1022s, device issues, though the LSORs also provided an opportunity for notes on accuracy and performance issues. Respondent presents (in its post trial opposition brief, p. 13-15) a series of pie charts analyzing these forms.

The LSORs contain boxes for "check marks" indicating particular customer issues. With respect to

the LSORs completed by Claimant Ruhe, there are 117 check marks in total, 5 for accuracy issues, 4 for performance issues. For Catala, there are 104 check marks, 3 for accuracy, 3 for performance. For all other TMs there are 2,189 check marks, 74 relating to accuracy, and 93 to performance. Total check marks for Claimants and the other TMs for performance and accuracy issues: 182.

With respect to the 1022s, Respondent's chart reflects that a total of 49 were submitted, 25 by Claimants, 24 by other TMs. Respondent urges that a disproportionate number were submitted by Claimants after they first consulted their counsel Mr. Bonagofsky.

Respondents also raise a number of legal defenses, addressed in the discussion below.

F. CLAIMANTS' REBUTTAL EVIDENCE. Claimants respond to the "after-acquired" evidence of Catala's misrepresentation on his employment application by noting that Catala did disclose the DUI on his application, discussed it with Birkle before being hired, and was told by HR that it was a "nonissue."

As to the theft of documents, Claimants point to the lack of any "settled company policy" against employee downloading of documents to which they have access. They cite evidence of an incident where Respondent condoned and participated in theft of data from the Belgian Red Cross, by Respondent's Belgian sales manager Raoul Bennis, of data relating to Orsense's devices. Bennis admitted copying the data without permission and forwarded it to Respondent's executives. [Ex. 729]. Bennis was not terminated for this activity.

With respect to Respondent's evidence that bad device results were frequently caused by erroneous

device use in the field, TMs who testified uniformly rejected the charge that they misused the devices. They stressed that they were trained to operate the devices correctly, and were spurred to greater care by the frequency with which company managers sought to blame bad device results on TM errors.

On the subject of LSORs and 1022s, Claimants rejoin that Respondent distorted the 1022 data in its attempt to show that Claimants submitted a disproportionate number of these after their apparent first consultation with counsel on August 24, 2010. Claimants say the fourteen 1022's Ruhe filed in October 2010 all grew out of the American Academy of Pediatrics trade show in San Francisco, which Ruhe attended with Kevin Hammond and also fellow TMs Corkie Matson and Celeste Grayson. The 1022s were submitted, Claimants say, on behalf of the group; Ruhe agreed to be the scribe. Thus, say Claimants, the inference urged by Respondent, that Claimants sought to load the record with 1022s after talking to counsel, is unwarranted.

3. Analysis and Decision

Claimants assert claims for 1) wrongful constructive termination in violation of public policy, a state common law claim; 2) violation of California Labor Code section 1102(c); 3) violation of the federal Dodd-Frank Act; and 4) violation of the California Unfair Practices Act. These claims and Respondents' defenses are addressed, and the relevant evidence discussed and weighed, below, following discussion and disposition of several preliminary issues.

Not every legal issue or argument raised by the parties is discussed below. Where the Arbitrator has found one defense to a claim dispositive, he has not

deemed it necessary to address and decide other arguments and contentions.

A. PRELIMINARY DETERMINATIONS

1) Collateral Estoppel. On October 3, 2013, as the Arbitrator prepared to release the Interim Award, he received notice from Respondent's counsel that the US District Court had granted summary judgment in favor of Respondent in a *qui tam* action brought by Claimants herein, *U.S. ex rel. Michael Ruhe, Kristine Serwitz, and Vicente Catala, etc., v. Masimo Corporation*, CV 10-08169-CJC. A copy of the summary judgment order was provided. Respondent's counsel offered to brief the significance of this order for the arbitration.

Because certain determinations in the summary judgment order appeared to overlap with issues in the arbitration, the Arbitrator ordered the parties to brief the impact of the order on the arbitration. The final brief was received October 21, 2013.

Collateral estoppel is "an affirmative defense barring a party from re-litigating an issue determined against that party in an earlier action." Black's Law Dictionary, p. 256 (7th Ed., 1999). The requirements of the doctrine are that the issue or issues subject to the estoppel must be identical to those in the prior action, and that the issues were fully and fairly litigated in the prior action. The goals of the doctrine are to save judicial resources, to protect parties against vexatious re-litigation of claims, and to avoid unseemly inconsistent judgments.

Respondent argues that the claims in arbitration are barred by the District Court's grant of summary judgment. Claimants argue the contrary.

The claims in the District Court *qui tam* suit were brought under the False Claims Act. The District Court explained that this statute was passed during the Civil War in response to fraud by government contractors, who were billing the government for services not rendered and submitting inflated invoices for services and goods. The claims brought by Catala and Ruhe in the *qui tam* case were for submission of false claims for money made to the government. As explained in the Introduction to the District Court's order, "Relators [Claimants in this arbitration] allege that Masimo knowingly made false statements in connection with its Pronto line of medical devices and those statements were *material to claims for reimbursement submitted to federal payer programs* such as Medicare." (emphasis added)

As the court further explained, Claimants in the *qui tam* case were required to prove: (1) a false statement or course of conduct, (2) made with scienter, (3) that was material, (4) causing the government to pay out money or forfeit monies due. [District Court Order, p. 13].

The gravamen of Claimants' claims in the arbitration is distinctly different. The main legal theory advanced by Claimants is that Masimo constructively terminated their employment by creating an intolerable working environment in which sales personnel were compelled to sell devices that Masimo knew to be unreliable and inaccurate. While some of Claimants' evidence in the arbitration concerns alleged false information provided to the FDA, the central thrust of the claims is that Masimo, knowing the devices to be unreliable and inaccurate, forced Claimants to continue selling them. The core claim of

constructive termination requires no proof that Masimo lied to the FDA, and indeed, Claimants have not attempted to prove that they personally knew about the misrepresentations to the FDA that Claimants offered as part of the evidence in the arbitration.

Masimo has expressly *admitted* that the arbitration claims and the *qui tam* claims are not the same. When Claimants sought to present evidence developed in the arbitration in opposition to summary judgment in the *qui tam* case, Masimo objected that the two cases were different:

> The claims in the arbitration are not the "same subject matter...." The Arbitration involved claims that Masimo (i) constructively discharged them in violation of public policy..., (ii) violated California Labor Code 1102.5 [retaliation], (iii) ...discharged them in violation of the Dodd-Frank...Act, and (iv) violated California's Business and Professions Code.... Thus, all the causes of action related to the arbitration concerned [Claimants'] employment and their decision to quit their positions with Masimo. The legal issues here [in the *qui tam* matter] are whether Masimo caused the submission of false claims to the government under the False Claims Act.

And, in a motion *in limine* seeking to exclude from the federal case depositions taken in the arbitration, Masimo similarly argued that the claims in arbitration were distinct and different from those before the federal court, that the two sets of claims did not involve the same subject matter, and that the arbitration was irrelevant to the *qui tam* case.

Thus, despite some factual overlap, the claims and issues in the two proceedings are not at all "identical," as required for application of collateral estoppel.

Further, the parties expressly agreed, as noted early in this statement of reasons, that arbitration would be "the sole means of resolving any disputes between Employee and Company" arising out of the employment relationship. After Claimants commenced an action in court asserting their constructive termination and related claims, Masimo successfully moved to compel arbitration, under the just quoted contract. Masimo's assertion that the federal court decision should now control resolution of Claimant's employment claims is a breach of the agreement that those claims be solely determined in arbitration.

A central purpose of collateral estoppel is to prevent wasteful duplicative litigation. But it is too late to achieve that purpose here. Masimo's summary judgment motion was not even filed until August 2013, after several years of pretrial preparation for the arbitration, completion of the extended and expensive two-week plenary arbitration hearing, preparation and submission of voluminous post-hearing briefs, oral closing arguments, and preparation by the Arbitrator of a substantial draft award, near completion at the time the District Court handed down its summary judgment. At no point during the arbitration did Masimo move to stay on the grounds that the arbitration was wasteful and duplicative, as the District Court would eventually decide key issues presented in the arbitration. Instead, as noted above, Masimo is on record in the District Court arguing that the two cases do not involve the same subject matter,

and evidence gathered in the arbitration should not be put before the District Court.

While the District Court briefly addressed the question of device inaccuracy, central in the arbitration, its discussion is limited to about two pages, near the end of its ruling, and addresses almost none of the voluminous and compelling evidence Claimants presented in the arbitration. The fact that both devices eventually were withdrawn or recalled by Masimo—evidence there were serious problems with them—is not mentioned by the District Court. The departure of 14 out of 18 TMs and the complaints of TMs other than the relators are not mentioned. Masimo's opposition to independent tests is not discussed, nor the extensive evidence of device failings and inaccuracies, nor the admissions by executives that the device was "a piece of crap" and so on. There was no full and fair hearing in the District Court of the claims presented in the arbitration.

For all the foregoing reasons, the Arbitrator respectfully declines to give collateral estoppel effect to the District Court summary judgment.

2) FDA Investigation. An additional threshold issue is presented by the parties' dispute whether the February 2011 FDA letter [Ex. 1155] re the FDA investigation should be considered. Claimants moved *in limine* for an order precluding Respondent from relying on the document. Claimants assert Respondent failed to comply with the Arbitrator's discovery order requiring Respondent to elect, by a date many months before the plenary hearing, whether it would rely on the FDA investigation.

In March 2012, nearly a year before the plenary hearing began, the Arbitrator imposed limits on the

time periods for discovery. At Respondent's request, December 2010 was set as the end of the discovery period—that is, documents or information prepared at or relating to times after the end of 2010 would not be required to be produced. Claimants were precluded from obtaining documents or information after that date. Further, in the same discovery proceeding, the Arbitrator gave Respondent 30 days to elect whether to attempt to offer the results of the FDA investigation of complaints about the Pronto and Pronto 7 in support of its defense in the case. The Arbitrator is not aware of any advice given by Respondent of election to rely on the investigation. Nonetheless, Respondent shortly before trial identified among its exhibits No.1155, the FDA's February 2011 report of its inspection at Respondent's facility following receipt of complaints about the Pronto 7, presumably Serwitz's and Claimants' letters.

Claimant moved *in limine* to exclude the letter, on the grounds it was outside the allowed discovery period, and further, that Respondent failed to make the election required by the March 2012 order, or to permit discovery about the investigation.

The Arbitrator concludes the motion should be granted. Respondent successfully argued against discovery beyond December 2010. It would be unfair to allow in evidence a potentially important document outside that period.

Moreover, were the document received and considered, it would be entitled to little if any weight. As detailed above, Respondents did not call the authors to testify and explain the report. And from the face of the report it is evident that the inspectors were not provided with and did not consider the mass of

evidence developed in the present proceeding and laid out at length above, which leads the Arbitrator to his conclusions herein.

3) Motion to Strike Additional Exhibits. Yet a further preliminary issue concerns the parties' post-hearing submission of documents. Following the plenary hearing the two sides discussed supplementing the record with some exhibits not discussed during the hearing. A tentative agreement was reached to allow Respondent to add 39 exhibits, in exchange for which Claimant would be allowed to add 20. The discussion evidently broke down when Respondent sought to add another 36 documents. Claimant moved to strike these additional exhibits, and also to strike a post-hearing expert declaration submitted by Respondent.

The Arbitrator resolves this dispute as follows. The case was pending for years before it came on for plenary hearing, and was then the subject of a full-blown two-week evidentiary hearing. There was ample opportunity for each side to offer the needed documentary evidence at the hearing. The evidentiary record is extremely voluminous without the supplemental evidence. And, consistent with the arbitration process, the Arbitrator was generally permissive in allowing documents into evidence. But enough is enough. None of the evidentiary documents tendered after the hearing have been considered. The ruling is the same as to the post-hearing expert declaration.

4) Preemption. As a further threshold matter, Respondents urge that all Claimants' claims are preempted by federal law controlling the manufacture, marketing and sale of medical devices. Respondents rely centrally on *Buckman Company v. Plaintiff's*

Legal Committee, 531 U.S. 341 (2001). In that case, plaintiffs injured by defective orthopedic bone screws sued the manufacturer and the regulatory consultant who assisted the manufacturer in applying for FDA approval to market the screws. Plaintiffs alleged defendants secured FDA approval for the devices by fraudulent representations in their applications for FDA approval or clearance. The Supreme Court held that the Food, Drug, and Cosmetic Act impliedly preempted state suits asserting claims based on alleged improprieties in the FDA application process. The Court said:

> [W]e hold that the plaintiffs state law fraud on the FDA claims conflict with, and are therefore impliedly pre-empted by, federal law. The conflict stems from the fact that the federal statutory scheme amply empowers the FDA to punish and deter fraud against the [FDA] and that the authority is used by the [FDA] to achieve a somewhat delicate balance of statutory objectives. The balance sought ... can be skewed by allowing fraud on the FDA claims under state tort law.

Claimants, on the other hand, rely on *Medtronic, Inc. v. Lohr*, 518 U.S. 4 70 (1996). In that case plaintiff alleged she had been injured by a defective heart pacemaker that had received FDA clearance. She asserted common law theories of negligent design and manufacture, strict liability, and failure to warn. Defendant relied on an express preemption provision in the Medical Devices Amendment to the FCDA which specified that "no state may establish ... with respect to a device intended for human use any requirement (1) which is different from, or in addition to, any

requirement applicable under the MDA to the device, and (2) which relates to the safety or effectiveness of the device or to any other matter included in a requirement applicable to the device under [the Act.]" The trial court dismissed the entire complaint; the court of appeal allowed some but not all of plaintiff's claims. The Supreme Court held that none of plaintiffs common law claims were preempted.

The applicability of the preemption defense varies according to the legal theory advanced. The Arbitrator will further discuss it in his analysis of the constructive termination and UCL claims. The state and federal retaliation claims are disposed of on grounds that do not require the Arbitrator to reach the preemption issue.

That portion of Claimant's proof challenging the manner in which Respondent resubmitted the Pronto 7 510k following initial rejection does squarely assert a fraud on the FDA. But this evidence is not material to Claimants' constructive termination claim. To fully understand the import of the evidence, one needs to see the comments by the FDA's Patel pointing out that diagnostic use of Pronto 7 for hemoglobin would require Class III treatment, or an exemption. Claimants did not know of this until long after they resigned, and do not and need not rely on it to show an intolerable working environment. They have offered it instead as additional evidence of management's attitude.

The Arbitrator will not, however give any weight in deciding any issue in this case to the evidence offered by Claimants of alleged fraud upon the FDA, either in the initial application for the Pronto, or in the Pronto 7

initial and subsequent applications, in recognition of *Buckman* preemption.

B. SUBSTANTIVE CLAIMS

1) Wrongful Constructive Termination. The California Supreme Court summarized the legal standard as follows:

> In order to establish a constructive discharge, an employee must plead and prove, by the usual preponderance of the evidence standard, that the employer either intentionally created or knowingly permitted working conditions that were so intolerable or aggravated at the time of the employee's resignation that a reasonable employer would realize that a reasonable person in the employee's position would be compelled to resign.
>
> For purposes of this standard, the requisite knowledge or intent must exist on the part of either the employer or those persons who effectively represent the employer, i.e., its officers, directors, managing agents, or supervisory employees. *Turner v. Anheuser Busch*, (1994) 7 Cal. 4th 1238, at 1251.

To prove a tort, the terminated employee also must show a "nexus" between the termination and a fundamental public policy. A Claimant also must show the termination caused his or her damages.

Here, the preponderance of evidence shows that Respondent knowingly created and maintained working conditions sufficiently intolerable to cause reasonable employees to resign. Respondent over a nearly two-year period pressured Claimants to sell and continue selling, and to tout the virtues of, medical

devices which abundant experience and evidence showed were faulty and did not perform as claimed. Claimants have presented abundant evidence of the devices' flaws, and Respondent has failed to provide compelling contrary evidence. The LSORs and 1022s on which Respondent in part relies instead support the claims, documenting a total of more than two hundred accuracy and performance complaints—wholly consistent with Claimants' proof. Further, Respondent's eventual withdrawal of both devices from the market is a powerful admission by conduct that the devices were not ready for market. Further, Respondent's executives made numerous express admissions on this point.

The evidence further establishes that senior management knew full well of the deficiencies, yet continued to deny their existence and to insist on continued sales efforts.

A preponderance of evidence further shows the conditions were sufficiently intolerable to cause reasonable employees to quit. Here, several other similarly situated employees also quit, and appeared at the hearing to testify as to why and how they could not countenance continuing to sell the devices. Many of the group of TMs hired to sell the device left; there is evidence that many of them were troubled by selling medical devices that gave false or inaccurate readings.

A salesman or saleswoman's reputation for honesty and integrity is a critical professional asset, probably the most important one. A salesperson who becomes known for false assurances about the product he or she is selling will lose that reputation. Further, those who possess and cherish a high reputation surely will feel great distress and humiliation if dissembling is made an

essential job function. A corporate environment where a salesperson is forced to do this, where he or she is told "your job is to sell the product, even if it catches fire in your hand," is no less intolerable for an honest, diligent employee, than one rife with racial prejudice or sexual harassment.

Respondent urged that problems of the kind shown by the evidence are a normal part of new medical device sales. In opening, it claimed that the initial Pronto marketing was a "Limited Market Release," a sort of trial run, and in closing, it argued that "clinical trial is not going to be the same as real world." At one point one of the sales executives told a TM "maybe you just shouldn't be selling new devices," as though doing so is not for those with scruples. Respondent, in substance, is arguing that new devices with unproven and questionable performance parameters properly can be field-tested and debugged in the process of initially marketing them, and that selling devices under these circumstances is normal and usual for sales representatives.

But Respondent cites no evidence nor any cases, statutes, guidelines, or regulations to support this concept. Respondent's expert FDA witness Ms. Graham testified that the FDA does not recognize the concept of a "Limited Market Release." Neither authority nor evidence nor common sense suggests that it is normal to continue marketing new devices and urging their virtues to users, when the seller has substantial reason to know the devices are inaccurate and unreliable.

Respondent's efforts to prove that Claimants departed out of greed, in hopes of a litigation windfall, are unpersuasive. Claimants were high-performing

sales personnel with good performance reviews until they departed. Both gave up a substantial income in the midst of the recession and the prospect of substantial sales bonuses when they resigned. Any prospective litigation recovery was highly contingent and uncertain. Moreover, the Arbitrator observed the demeanor of the Claimants and other departed TMs, and concludes they were genuinely disturbed by a job that required them to sell devices they strongly and reasonably believed to be defective.

Claimants also establish that their claims involve fundamental public policy. *Green v. Ralee Engineering Company* (1998) 19 Cal. 4th 66. In *Green*, the plaintiff alleged he was terminated for complaining about his employer's shipment of airplane parts that failed to meet Federal Aviation Authority standards for inspection. The court found that plaintiff had shown the required fundamental public policy connection, because the federal aviation regulations reflected and furthered an important public policy. "There is no public policy more important or fundamental than the one favoring the effective protection of the lives and property of citizens." The court further noted that the policy "did not merely serve the employer's or employee's personal or proprietary interest."

By close analogy to *Green*, Claimants' claims here also implicate fundamental public policy. Claimants' concerns with the inaccurate devices were not merely personal or proprietary, but on the contrary, centered on the public safety and health implications of the inaccurate medical devices. Like the parts and inspections in *Green*, the devices here were the subject of an important body of federal regulatory law, all

designed for public protection in the critical health arena.

Respondent urges that notice is an essential element of a constructive termination claim. No formal notice requirement appears to be part of the necessary elements in a case where, as here, the evidence shows that management knowingly created and maintained the intolerable conditions. Moreover, there was ample notice here, in the form of the TMs' repeated complaints to their managers about their experiences with device malfunctions, and their angst at continuing to sell them. And, Ms. Serwitz gave formal notice weeks before Claimants resigned, a complaint which Respondent did not forward to the FDA for six weeks, and then with a blanket denial of wrongdoing.

The constructive termination claims are not preempted. These claims are not principally based on fraud on the FDA or in FDA applications or clearance process. Claimants contend Respondent engaged in a long-running course of selling devices to doctors and clinics accompanied by performance claims, in particular the accuracy specification, which Respondent knew were false. This is not a claim of fraud in the regulatory process, nor a claim that involves a state imposing a requirement on a medical device that is inconsistent with requirements imposed by the FDA.

Further, Claimants' allegations that the misrepresentations violated FDA labeling regulations are considered for the purpose of showing that the misrepresentations implicate public policy, not as proof of claims of fraud on the FDA. This consideration is not preempted under *Buckman*. It does not threaten to interfere with FDA processes.

On the other hand, the claims and evidence that Respondent improperly avoided reporting a recall of the Pronto to the FDA, and that it essentially committed fraud on the FDA in obtaining clearance for the Pronto 7, are within the preemption zone. They squarely assert a fraud on FDA processes, and *Buckman* instructs that such claims are preempted. The Arbitrator gives this evidence no weight in sustaining Claimants' constructive termination claims, which, as explained, rest on independent proof of an intolerable work environment characterized by pressure to sell devices known to be defective, and eventually conceded by Respondent to be so.

2) California Labor Code § 1102(c). Claimants assert claims under this subsection of the California Labor Code, which provides: "(c) An employer may not *retaliate* against an employee for refusing to participate in an activity that would result in a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation." (Emphasis added)

Giving the word "retaliation" its accepted and plain meaning, this statute requires an intentional act of "repayment" or revenge for some act or offense by the employee. The Merriam Webster Online Dictionary defines "retaliate" as "to repay (as an injury) in kind;" to "return like for like;" and "to get revenge." The manifest statutory objective is to prevent employers from "repaying" or taking revenge against employees who engage in a protected activity to the employer's disadvantage.

The "repayment" or "revenge" unquestionably may take the form of hostile or adverse employment actions leading to a constructive termination. For example, in

the *Wallace* case cited by Claimants, the employing police department was found to have engaged in a pattern of adverse employment actions against plaintiff in response to his exercise of rights to take military leave. In the *Lockheed* case relied on by Claimants, an employee who complained about a superior's improper liaisons with military personnel was subjected to a series of adverse actions instigated by the target of her complaints, and eventually resigned. The court upheld a claim of retaliation based on the adverse actions leading to constructive termination.

In the present case, though, Respondent's conduct giving rise to the constructive termination, the insistence that the TMs keep selling the deficient devices, was not done in retaliation for anything. There is no evidence that Respondent's insistence that the TMs keep selling was motivated by a desire to "repay" Claimants for complaining, or to punish or obtain revenge against them for protected activity. Rather, the evidence shows that Respondent was motivated by an obstinate desire to keep selling the devices, to be first to the market with a noninvasive device, in the face of the persistent evidence of the device's deficiencies. In short, Claimants have not proven there was any "retaliation" in this case.

Section 1102(c) is explicitly a statute that prohibits *retaliation*. Respondent's conduct, however reprehensible, was not *retaliatory*. Conduct supporting a claim of constructive termination can also supply the adverse action against an employee that is a necessary element of a retaliation claim. But it does not follow that every constructive termination is also retaliation. An intolerably hostile sexual environment, for example, might readily support a claim for

constructive termination without also making out a claim for retaliation.

Here, Claimants offer no proof of retaliatory motive or intent, and so fail to establish a retaliation claim. Respondents insisted on aggressive selling of the devices because they wanted to sell the devices—not because they were taking revenge against Claimants or punishing them for conduct Respondent did not like.

The authorities have not, so far as the Arbitrator can see, stretched the notion of constructive termination to encompass some sort of constructive retaliation.

In light of this fatal defect, the Arbitrator need not discuss Respondent's other challenges to this claim.

3) Dodd-Frank Act. This statute, like California Labor Code § 1102.5(c), is an anti-retaliation law. It bars retaliatory action against whistle-blowers. Claimants' claims fail for the same reason discussed above: their evidence does not show retaliation.

4) UCL, FAL. Claimants seek only injunctive relief on these California statutory claims. Several formulations of the injunctive relief requested appear in earlier filings (Claimants' complaint in federal court; Claimants' prehearing brief.) Claimant's opening post-hearing brief contains the most current formulation of requested injunctive relief, and describes the injunction sought as follows:

> Claimants seek an injunction ordering the production to FDA of all of the clinical trial information that they have obtained regarding the SpHb parameter, whether the Rainbow SET version used in the Radical-7 and Pronto, or the Rainbow 4D version used in the Pronto-7. The

> Arbitrator should further order the production to FDA of the record in this case with its abundant evidence of Masimo's false and misleading statements made while engaging in off-label promotion of the SpHb devices, as well as its fraudulent and misleading conduct *vis-à-vis* the FDA itself. This injunctive relief will assist in shining some much needed light on the business practices that Masimo has hidden from FDA since it first applied for 510(k) clearance of SpHb in 2008, and since it began marketing SpHb thereafter. [Claimants' opening brief, p. 109]

The Arbitrator concludes that he is barred from awarding such relief by federal preemption. *Buckman*, *supra*. The FDA, not arbitrators, has the power to determine what should be submitted to it, and to order accordingly.

C. DAMAGES

1) Economic Damages. Claimants' forensic economist calculated Claimant Ruhe's economic damages at $112,443, and Claimant Catala's at $97,613. These calculations appear to be conservative and correct. Respondents did not seriously challenge them. These damages are awarded as requested.

2) General Damages. The Arbitrator is not inclined to award significant general damages. Claimants were not subjected to the humiliation of being fired. They left of their own volition, with resumes unblemished by firing, free to try to vindicate their claims that Respondent was misbehaving. They did not, as noted, suffer long periods of unemployment, despite resigning during the recession. And, the working environment, while intolerable for the reasons detailed above, did not

entail the kind of personal degradation and humiliation that would inhere in an atmosphere of severe sexual harassment or racial discrimination. Claimants were generally treated well and given good performance evaluations until late in the game.

On the other hand, there doubtless was some measure of personal distress occasioned by dealing with angry and distrustful customers, continuing to attempt to sell products Claimants believe flawed, and also with stepping out into the job market with the recession still in progress.

The Arbitrator awards each Claimant $50,000 in general damages.

3) Punitive Damages. The Arbitrator found in the Interim Award that Claimants have shown malice, fraud, and oppression (Cal. Civil Code § 3294) by clear and convincing evidence, sufficient to justify an award of punitive damages, subject to constitutional limits, in some amount to be determined in follow-on proceedings. The discussion in the Interim Award was as follows:

> Respondents persisted in selling the devices long after it was clear that they did not perform according to the specification. That the devices were not ready for market is proven most definitively by Respondent's own actions in eventually withdrawing them. Nonetheless they persisted in marketing them for some two years, in the face of a flood of reports from their own TMs and other sources demonstrating the devices did not perform accurately or to specification. They did so in the face of knowledge that the devices, at least in certain settings, could seriously endanger patients by

erroneous readings. Despite these hazards, they promoted the devices for diagnostic use.

Further, they were unrepentant in the arbitration. All the senior executives continued to assert that the devices always conformed to specification, in the face of a wealth of contrary evidence. In closing arguments, Respondent urged that it "always did the right thing," a claim strongly belied by the evidence. It argued that the devices were simply intended to provide a supplemental source of information, not a diagnostic device, though the weight of the evidence showed Respondent fully intended to market the devices as diagnostic. The whole thrust of the campaign was that these devices were noninvasive. But the touted noninvasive character of the devices would little benefit patients if they need to be stuck with a needle anyway, because the noninvasive device is only a supplemental information source. And why would doctors pay thousands of dollars for additional equipment to use only as a sort of back up to the reliable traditional equipment they already possessed?

Further, contrary to Respondent's contention, this behavior emanated from the highest levels in the company.

In reaching these conclusions, Arbitrator emphasizes that he is *not* considering, and will not consider Claimants' evidence and arguments of fraud in the FDA processes, as such consideration is preempted. *Buckman*, *supra*.

> Any punitive damages that may be awarded will be subject to the appropriate constitutional and other limitations relating the amounts of general damages awarded in the case, and any other criteria which properly apply.

Following the issuance of the Interim Award the parties tendered extensive submissions further addressing punitive damages, and these issue were in addition one of the subjects of the four-hour hearing January 10, 2014. The Arbitrator now takes up these issues.

Punitive or exemplary damages are an established feature of our jurisprudence. Unlike compensatory damages, which are intended to make a plaintiff or claimant whole for damage inflicted by another's wrongful conduct, punitive damages serve different purposes. Their purpose is to deter the defendant or respondent from repetition of the wrongful conduct, and also to deter or discourage others from similar misconduct.

In California, consideration of punitive damages is typically divided into two phases. In the main hearing on the merits of the case, the tribunal decides whether Claimant has demonstrated that the Respondent is guilty of conduct warranting a punitive award. Claimant must show, by clear and convincing evidence, that Respondent has been guilty of malice, fraud, or oppression. If this "predicate finding" is made, the tribunal then considers, in a second phase of the proceedings, the appropriate amount of such damages. The Arbitrator explicitly adopted this framework for this case, stating in his third Pretrial Conference Order dated December 15, 2011, as follows:

> Issues relating to the predicate finding for punitive damages will be tried during the first phase, the 10-day plenary hearing. If there is a predicate finding made, the quantum of punitive damages can be addressed in a separate, later hearing, or possibly on the papers only.

As noted above, during the interval between the rendering of the Interim Award and the punitive damage hearing Respondent proposed that the arbitation be stayed, so that Respondent could conduct a new "validation study" demonstrating that the devices in issue in the case conformed to specification issued by Respondent. The Arbitrator denied this request on the ground the time for presentation of evidence on the merits of the case had long passed. (Respondent renewed this proposal during its argument on January 10th.)

In its briefs and submissions for the hearing on the quantum of punitive damages, Respondent continued its effort to re-litigate the predicate finding, and indeed the entire decision on the merits in the Interim Award. A major part of Respondent's presentation, captured in a powerpoint slide deck presented at the January 10, 2014 hearing, amounted to reargument of the merits of the case, and the predicate finding. Further, Respondent offered extensive new evidence not offered in the plenary hearing, including declarations from new expert witnesses, and evidence relating to periods of time after December 2010, the end date of the discovery period established early in the case. Respondent had argued for this deadline, and the Arbitrator had adopted it over Claimants' objection.

Respondent's counsel further argued on January 10th that evidence from periods after December 2010

was relevant to punitive damages, and should be considered, citing *Bullock v. Philip Morris* (2011) 19.8 Cal. App. 4th 543.

But, if evidence from the time after December 2010 was legally relevant on the predicate finding issues, as Respondent contended in its punitive damage argument, then Respondent should not have urged the Arbitrator to set December 31, 2010 as the later terminus of the discovery period. This ruling prevented Claimants from obtaining discovery information for later periods, yet Respondent now seeks to introduce reams of evidence relating to later periods to avoid punitive damage liability. This continues the pattern of behavior noted earlier where Respondent, having successfully argued that evidence after December 2010 should not be discovered, nonetheless attempted to introduce and rely on the FDA's 2011 investigation. Respondent appears to believe that the discovery period it argued for, and persuaded the Arbitrator to accept, was a one-way street which applied only to Claimants.

The Arbitrator declines to reopen or revisit the predicate findings, and declines to consider the new evidence tendered by Respondent.

Respondent's counsel also argued at the January 10th hearing that the question whether punitive damages were warranted was "bifurcated" and would be addressed at a hearing subsequent to the plenary hearing. But, the December 2011 Pretrial Conference Order No. 3 was clear that the predicate finding was to be addressed in the plenary hearing and decided based on the evidence and arguments presented in connection with that hearing. Further, this sequence was entirely typical of the way the issue is handled in California

cases. Civil Code§ 3294 precludes discovery concerning a defendant's financial condition until after the court has made a predicate finding in the main trial finding the conduct which warrants punitive damages. Financial information is discoverable *after* the predicate finding, for introduction in considering the quantum of punitive damages. Thus Civil Code § 3295(d) provides, "The court shall, on application of any defendant, preclude the admission of evidence of that defendant's profits or financial condition until after the trier of fact returns a verdict against that defendant and finds that defendant is guilty of malice, oppression or fraud in accordance with section 3294."

Respondent was on full notice that its evidence on whether punitive damages should be awarded must be presented during the plenary hearing. Punitive damages are authorized by California law when clear and convincing evidence establishes that defendant or Respondent has been guilty of malice, fraud, or oppression. Malice includes conduct which reflects indifference to or conscious disregard for the rights or health and safety of others. As explained above, Respondent's conduct was shown to meet this standard. Its sales force, whose core activity was to sell the Pronto devices, were knowingly compelled by Respondent to sell devices which they and their employer knew to be unreliable, concealing or failing to reveal their knowledge of device unreliability. This harmed the TMs selling the Pronto devices, the vast majority of whom left Respondent rather than continue this activity. Further, doctors and clinicians who were the subject of this campaign were harmed by being induced to purchase the devices. And, the patients whose treatments involved reliance on the devices

were at risk of harm, and in at least one instance actually harmed.

The harm was not more widespread only because treaters relied primarily on established, approved methods for drawing blood. Respondent's campaign to induce HemoCue users to trade in their machines, had it been successful, could have exposed many more patients to dangerously inaccurate readings. This conduct was oppressive to Respondent's salespeople and indifferent to their rights and the rights and/or safety of doctors, hospitals, clinics, and patients.

The thrust of Respondent's response to these points in its brief addressing the quantum of punitive damages and in oral argument Janaury 10th was to urge that all the "validation studies" done of the Pronto devices have shown them to function within the specification (here counsel displayed a graphic showing studies from 2011, 2012, and 2013). Putting aside the substantial amount of contrary evidence, the argument entirely misses the point. A manufacturer cannot defend a device which repeatedly fails in actual use in the field by arguing that it worked in the lab. Nor can it argue that its conduct was in good faith because its lab tests confirmed proper performance, when a wealth of information conveyed to the manufacturer's executives proved that the device was not working consistently or reliably with patients and medical providers in the field. Testimony from Respondent's Engineer Marcelo Lamego, cited by Claimants' counsel during the punitive damages arguments, made exactly this point, which common sense in any event compels: the critical test of any device intended to be used with real patients in the real world is real world performance, not laboratory performance.

An additional factor also supports the imposition of punitive damages. Misconduct in litigation is appropriately considered in this determination. As the Court of Appeal explained in *CGB Occupational Therapy v. RHA Health Services, et al.*, 499 F.3d 184, 193-195 (3rd Cir. 2007), abusive litigation tactics are properly considered in fixing the amount of punitive damages.

The record in this case shows a series of questionable and abusive tactics.

Respondent's repeated effort to inject new, post-December 2010 evidence into the case is indefensible, especially in the punitive damage case, after the Arbitrator had explained in the Interim Award the impropriety of this behavior. Respondent's invitation, if accepted, would have required Claimants to respond to a whole new body of evidence, in effect re-litigating the merits, without the benefit of any opportunity to investigate the new evidence through discovery. Respondent's request following issuance of the Interim Award to suspend the proceedings to allow a new validation study was similarly calculated to delay the outcome and increase the expense and burden for Claimants.

Equally indefensible is Respondent's invitation to ignore the clear, early ruling that the predicate findings for punitive damages would be made based on presentations at the plenary hearing. This, again, if accepted, would require Claimants to litigate and win the case anew. As the court in *CGB* explained:

> Wealth is also relevant because "[a] rich defendant may act oppressively and force or prolong litigation simply because it can afford to do so and a plaintiff may not be able to bear the

> costs and the delay." *Continental Trend*, 101 F. 3d at 642; *accord Mathias v. Accor Economy Lodging, Inc.*, 347 F.3d 672, 677 (7th Cir. 2003) (Posner, J.) ("[W]ealth in the sense of resources ... enable[s] the defendant to mount an extremely aggressive defense against suits such as this and by doing so to make litigating against it very costly....") [At 194.]

Arbitration was imposed on Claimants by Respondent's choice. Arbitration is intended to be expeditious. Respondent has instead sought to delay and drag out the proceedings.

Respondent's attempt to use the *qui tam* summary judgment to foreclose a decision on the merits in the arbitration also can be seen, in the context of the other conduct just discussed, to be abusive.

To begin with, Respondent agreed and promised that arbitration would be the exclusive forum to decide claims arising out of Claimants' employment. By seeking to resolve the claims based on a ruling in the *qui tam* case, Respondent attempted to avoid that promise.

Further, the *qui tam* case was filed before the arbitration. If Respondent in good faith believed that the District Court would or could decide issues also presented in the arbitration, it should have moved to stay one or the other case, to allow a binding decision by one tribunal or the other without duplication of effort and expense and the potential for conflicting outcomes. Instead, it sat mum, an owing Claimants to bear the huge expense and effort of the arbitration, and to litigate the *qui tam* case at the same time, then trying to impose the District Court's ruling in the arbitration—even after telling the District Judge that

the subject matters of the two cases were different, and opposing introduction of the arbitration evidence in the District Court case.

Respondent's request that the Arbitrator withdraw, made 36 hours or so before the hearing on the quantum of punitive damages and on attorneys fees, was an additional abusive tactic, unjustified factually or legally, and designed to derail the case on the very brink of closure, sending Claimants back to square one after years of difficult, expensive litigation had finally vindicated their claims.

Also highly questionable is Respondent's citation of U.S. Supreme Court authority as barring consideration of potential harm to others in determining reprehensibility for quantifying punitive damages (see discussion below at pp. 59-60). This is a critical point on perhaps the *most* critical issue re the amount of punitive damages, and Respondent's brief outright misstated the law.

While not central to the decision to impose punitive damages, these abusive tactics furnish an additional basis for the imposition of punitive damages in the amount set below.

The Arbitrator turns now to the question of the proper quantum of punitive damages. The United States Supreme Court has held that the due process clause of the Constitution imposes limits on the *amount* of such damages that may be awarded. A threshold issue is whether United States Constitutional constraints on punitive damages apply in the arbitration. Claimants assert that because the matter is in arbitration, constitutional limits on punitive damages do not apply, citing a recent California appellate case, *Shahinian v. Cedars-Sinai*

(2011) 194 Cal. App. 4th 987, 1007-08. The holding is that private arbitrations do not involve state action and therefore are not subject to constitutional limits.

Despite this holding, the Arbitrator will proceed with due process analysis, and conform the award to due process standards. Even if Constitutional standards are not binding in private arbitration, participants in arbitrations do expect a fair process, and the Constitutional standards certainly furnish guidance as to what constitutes fair process in the punitive damage context. Claimants contend that the range of awards they request comport with due process standards, and the Arbitrator agrees.

Due process requires that judges and juries not award more than amounts "reasonably necessary to vindicate the State's legitimate interest in punishment and deterence ... " Grossly excessive awards could "violate elementary notions of fairness enshrined in our constitutional jurisprudence." *BMW of North America v. Gore* (1996) 517 U.S. 559, 568, 574. The court established three "guideposts" for application in determining whether punitive awards are excessive: (1) the reprehensibility of defendant's conduct, (2) the ratio of punitive damages to the actual harm inflicted on plaintiff, and (3) civil or criminal penalties that could be imposed for similar conduct.

The court went on to instruct that "the most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." And, in evaluating reprehensibility, the tribunal is directed to consider whether the harm caused was physical as opposed to economic, whether the tortious conduct evinced an indifference to or reckless disregard for the health and

safety of others, whether the target was finanically vulnerable, whether the conduct was repeated or isolated, and whether the harm resulted from intentional malice, trickery, or deceit, or mere accident.

On the issue of reprehensibility, the Supreme Court held in *Philip Morris USA v. Williams* (2007), 549 U.S. 346, 357, as follows:

> We did not previously hold that a jury may not punish for the harm caused others. But we so hold now ... At the same time we recognized that *conduct that risks harm to others is likely more reprehensible than conduct that risks harm to only a few. And a jury consequently may take this fact into account in determining reprehensibility*." (Arbitrator's emphasis)

Addressing the question of appropriate ratios between compensatory and punitive damages, the Supreme Court in *BMW* held that "single digit multipliers are more likely to comport with due process ... than awards with ratios in range of 500 to 1", but also that a higher ratio might be appropriate in cases when a "particularly egregious act" had resulted in a low award of compensatory damages. [*Id.* at 582.]

The parties have cited numerous employment litigation cases where punitive damages have been awarded. Some of these are abstracted in the following table (damages in millions of dollars):

Case Name	Cite	Compensatory Damages	Punitive Damages	Total Damages	Ratio
Belk	2010 WL 2796875	0.08	0.08	0.16	1 to 1
Bullock	198 Cal. App. 4th 543	0.95	13.86	14.7	15 to 1
Casella	157 Cal. App.4th 1127	0.24	0.24	0.48	1 to 1
Czarnik	2004 WL 2757571	2.196	2.196	4.3	1 to 1
Deters	202 F.3d 1262, 2000	0.005	0.295	0.3	59 to 1
EEOC v. FedEx	513 F.3d 360 (2008)	0.008	0.1	0.108	12.5 to 1
Green	192 Cal. App. 4th 441	1.237	1.237	2.474	1 to 1
Halloran	2006 WL 401815	1.327	0.75	2.1	.57 to 1
Hampton	247F.3d 1091	0.056	1	1.056	19.6 to 1
Roby	47 Cal. App. 4th 686, 692-693	1.9	1.9	3.8	1 to 1
Romano	233 F.3d 655	0.015	0.285	0.3	19 to 1

Case Name	Cite	Compensatory Damages	Punitive Damages	Total Damages	Ratio
Simon	35 Cal. App. 4th 1159, 1189 (2005)			1.5	300 to 1
Shahinian	194 Cal. App. 4th 987	2.108	2.58	4.691	1.22
Swinton	270 F.3d 794 (9 Cir. 2001)	.0056	.03	1	28 to 1

The table shows, among other things, that the 1-to-1 ratio cases relied on by Respondent involved substantial compensatory awards: *Casella* ($480,000 total award), *Czarnik* ($4.3 million total), *Green* ($2.4 million), *Roby* ($3.8 million after reduction on appeal), *Shahinian* ($4.6 million). In these cases the total recovery was sufficiently large to have a deterrent effect.

The cases Claimants rely on as justifying a ratio significantly higher than 1 to 1 involved relatively small compensatory awards (*EEOC*, *Hampton*, *Romano*, *Swinton*). Claimants' argument for a higher ratio is supported by the observation in *BMW* that a higher ratio may be warranted where there is a small compensatory award, and a particularly egregious act. Also supporting a larger than 1 to 1 ratio is the holding in *Philip Morris* that harm and potential harm to third parties is properly considered in assessing reprehensibility, a factor which if present justifies a higher ratio and larger punitive award. The deterrent purpose for punitive damages also argues for a larger award where compensatory damages are small. Bad conduct which fortuitously produces only modest harm may nonetheless warrant punitive damages.

It warrants mention that the reason the compensatory damages are low in this case is because the Claimants were good salesmen and rapidly found substitute employment, even in difficult rescessionary times. Claimants' diligence in mitigating their damages does not furnish a compelling reason to minimize punitive damages, especially in light of Respondent's considerable wealth.

Consideration of the defendant's wealth is highly relevant to the quantum of punitive damages, because

the effectiveness of the deterrent purpose will in part be a function of whether the award has a material financial impact. "[T]he function of deterrence ... will not be served if the wealth of the defendant allows him to absorb the award with little or no discomfort." *Bankhead v. ArvinMeritor, Inc.* (2012) 205 Cal. App. 4th 68, 77-78.

Claimants cite publicly available evidence which shows Respondent's financial condition, in summary, to be as follows:

	2009	2010
Gross revenues	$350 million	$400 million
Net income	$53 million	$74 million
Assets	$350 million	$350 million

Claimants urge that punitive damages be fixed in the range between $4.6 million (15 times the total compensatory damages awarded) and $7.7 million (25 times compensatory damages). They urge that numbers in this range are necessary to have any hope or prospect of deterring future similar misconduct by Respondent. They argue that Respondent's conduct was highly reprehensible, involving indifference or reckless disregard for the rights and safety of others, an ongoing course of misconduct rather than an isolated incident, and intentional as opposed to accidental wrongdoing. They contend constitutional limits will not be exceeded by an award of punitive damages in a ratio to compensatory damages greater than 10 to 1.

Respondent counters with a number of arguments.

Respondent protests that due process standards *do* apply, notwithstanding that the matter is in a private

arbitration. As noted above, the Arbitrator agrees, and will apply these standards.

In an important mischaracterization of the law critical for the punitive quantum calculation, Respondent urges, as noted above, that the Arbitrator can only consider the harm to Claimants, and not the risk of harm to doctors, patients, clinics, and hospitals, in determining the reprehensibility of Respondent's conduct. Respondent's brief states, "Claimants rely upon the potential harm to the health and safety of others, not themselves. But ... Claimants cannot rely upon such third-party harm to prove reprehensibility." [Respondent's brief, 20/28-21/1, citing *Phillip Morris*]

But the holding in Phillip Morris, is directly to the contrary:

> We did not previously hold that a jury may not punish for the harm caused others. But we so hold now. … At the same time *we recognized that conduct that risks harm to others is likely more reprehensible than conduct that risks harm to only a few. And a jury consequently may take this fact into account in determining reprehensibility.* (Arbitrator's emphasis)

Here, the widespread potential harm to doctors, patients, clinics, and hospitals, as well as the harm to numerous other TMs as well as Claimants, is highly relevant and strong evidence of reprehensibility.

Respondent urges that these third parties were not actually harmed by its conduct. It is true that only limited actual physical harm resulted from Respondent's campaign to sell its defective devices. One patient whose hemoglobin was inaccurately read required a blood tranfusion. The limited impact,

though, resulted almost entirely from the fact that the devices were used almost always in a kind of backup or redundant capacity, with reliable measurements from established test methods available to deter reliance on the Prontos' unreliable readouts. But Respondent was *trying* to replace the reliable devices, offering its own in exchange for the blood drawing machines. And there can be no doubt that its ultimate objective was to widely replace the "invasive," painful draws of blood by needles and finger sticks with a painless, noninvasive device.

Respondent argues that the *qui tam* action "resolved" the question of impact on third parties, "rejecting" the assertion that Respondent was engaged in a fraud against users and the government agencies. [Respondent's Brief, 21.]

But, as discussed in detail above, the *qui tam* action involved fraud on the government, not harm to patients, doctors, clinics and hospitals. Respondent told the federal court there was no overlap between the arbitration claims and the *qui tam* action, and opposed the introduction of evidence from the arbitration in the *qui tam* action.

Here, the compensatory damages are very modest, and the bad conduct impacted not only Claimants but their fellow salesmen, and the patients, doctors, clinics and hospitals they serve. The conduct was engaged in over a long period of time, and showed gross indifference to the rights and safety of the sales people, doctors, clinics, hospitals, and patients.

The Arbitrator awards punitive damages of $5 million—$2.5 million to each Claimant. The conduct proved by Claimants justifies this award, and a smaller sum would not serve the deterrent purposes intended,

given Respondent's great wealth, and also its attitude as displayed during the arbitration. This award is in no sense disproportionate—it is only a fraction of Respondent's annual net income. The award is 16 times the total compensatory award. Together with the compensatory damages and costs, the total award to the two Claimants is just under $5.4 million, just under more than $2.7 million each. This is comfortably in line with total awards to individual plaintiffs in other recent employment cases, albeit those awards include larger compensatory damages and lower punitive awards (*Czarnik*, $4.3 million, *Green*, $2.47 million, *Roby*, $3.8 million, *Shahinian*, $4.6 million.) The Arbitrator concludes that under all the circumstances the ratio here comports with due process.

The Arbitrator acknowledges that punitive damage awards are rare, and that they are a powerful remedy. The Arbitrator cannot recall awarding such damages in any of the other hundreds of awards he has rendered over the past dozen years. Further, the Arbitrator is a fan of the American medical industry, and believes that innovative devices it has developed have made huge strides in improving the health and quality of life of Americans and others around the world. But along with great contributions to mankind, and the high financial rewards that come with these, go high responsibilities for good corporate behavior. The shabby behavior chronicled above falls below that which is or should be acceptable and warrants the award.

D. ATTORNEYS' FEES AND COSTS

These also were extensively briefed and then argued at the hearing January 10, 2014.

1) Attorneys' Fees

Claimants seek an award of attorneys' fees under California Code of Civil Procedure § 1021. This section authorizes a court (or arbitration tribunal) in its sound discretion to award fees on motion of a party where an action has resulted in enforcement of important rights affecting the public interest if (a) significant benefit, pecuniary or non, was conferred on the general public or a large class of persons, (b) the necessity and financial burden of private enforcement are such as to make the award appropriate, and (c) the fees should not, in interest of justice, be paid out of recovery.

This section is an exception to the generally prevailing "American Rule," which holds that, absent a statutory provision or contract clause specifically authorizing recovery of attorneys' fees, a successful litigant must bear his or her own attorneys' fees. Claimants' constructive termination claims are non-statutory, non-contractual claims which ordinarily would carry no right to attorneys' fees. Claimant's statutory claims under federal and state law have been rejected, so there is no fee entitlement associated with those claims. In order to avoid the American Rule, and obtain fees under § 1021 for success on the common law constructive termination claims, Claimants must affirmatively satisfy each of the statute's elements.

At first blush, a successful claim for wrongful termination in violation of public arguably always vindicates important rights and confers a significant benefit on the public, by enforcing important public policy. But, as the California Supreme Court has explained, this is not enough for § 1021 fees:

> Of course, the public always has a significant interest in seeing that legal strictures are

> properly enforced and thus, in a real sense, the public always derives a "benefit" when illegal private or public conduct is rectified. Both the statutory language ("*significant* benefit") and prior case law, however, indicate that the Legislature did not intend to authorize an award of attorney fees in every case involving a statutory violation. We believe rather that the Legislature contemplated that in adjudicating a motion for attorneys' fees under section 1021.5, a trial court would determine the significance of the benefit, as well as the size of the class receiving benefit, from a realistic assessment, in light of all the pertinent circumstances, of the gains which have resulted in a particular case.... *Woodland Hills Residents Association v. City Council* (1979), 23 Cal. 3d 917, at 939.

Consistent with this holding, the courts have required more than mere success on a claim related to public policy to meet the important rights/significant benefit element of the statutory showing. In *Baggett* and *Jaramillo*, suits under the Police Officers Bill of Rights resulted in permanent injunctions enforcing the statutes against major police departments. In *Robinson v. Chowchilla*, the plaintiffs ultimately successful suit produced a published opinion clarifying the Police Officer's Bill of Rights Law and enhancing its general effectiveness. In *Graham v. Daimler*, plaintiff's suit induced defendant auto maker to implement a general corrective program even before the suit was decided.

These kinds of results are not present in the current matter. Claimants' request for an injunction was denied. The Arbitrator declined to order any relief

regarding the FDA, on the grounds that federal law preempted such relief. Further, it cannot be claimed that Claimants' initiation of the litigation directly stimulated a change in Respondent's behavior, as in *Graham*—the removal of the devices from the market in December 2010 preceded any filing by Claimants.

It is true that Claimants' investigation and prosecution of their claims exposed a course of conduct which otherwise might have gone undiscovered. But no case cited has held that the mere revelation of misconduct incidental to pursuit of claims is sufficient benefit to invoke § 1021. Were this otherwise, it would seem that every suit adjudicating that a termination was in violation of public policy arguably should trigger § 1021 fees.

Claimants cite no constructive termination case where § 1021 fees have been awarded.

One might plausibly argue that obtaining an award of punitive damages should satisfy the "significant benefit" requirement, since the purpose and presumably the effect is to deter future bad conduct, to the benefit of other people who might otherwise be victimized. But no case has been cited which embraces this theory, and at least one well-known case where a large punitive damage award was obtained rejected a request for § 1021 fees. *Weeks v. Baker & McKenzie* (1998) 63 Cal. App. 4th 1128, 1170-71.

Further, Claimants' success in obtaining a substantial punitive damage award cuts against another of the predicate elements for a § 1021 award: "fees should not in the interests of justice be paid from the recovery." Punitive damages are a windfall to the successful plaintiff or Claimant. By definition, plaintiff has been made whole by the compensatory award.

The windfall here is substantial. It is not contrary to the interests of justice to require that some portion of the windfall be devoted to paying the fees of the attorneys who procured it and the costs of litigation. The punitive damage award provides ample funds to pay the attorneys' fees and unrecoverable costs and yet allow Claimants a significant premium above their compensatory award.

The request for attorneys' fees is respectfully denied.

2) Costs

Claimants seek to recover $107,027 in costs. Respondent has objected to eight items, detailed at page 29 of its brief opposing the fee application. The proposed disallowed items and adjustments reduce the total recoverable fees to $80,529. The objections are proper, and are sustained, and the costs recoverable are reduced to $80,529.

4. Relief Awarded

Claimant Ruhe is awarded $112,443 in economic damages, $50,000 in general damages, and $2.5 million in punitive damages. Claimant Catala is awarded $97,613 in economic damages, $50,000 in general damages, and $2.5 million in punitive damages. Claimants shall recover their costs in the amount of $80,529. Claimants shall bear their own attorneys' fees, as well as any costs in excess of those awarded here.

This is a Final Award, intended to be subject to confirmation by a court. This Award is rendered January 15, 2014.

The Case Manager, Jose Patino, is requested promptly to issue this Final Award.

By: s/ Richard C. Neal
Hon. Richard C. Neal (Ret.)
Arbitrator

9 U.S.C. § 10

§ 10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(b) If an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.

(c) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.

Judicial Arbitration and Mediation Services Comprehensive Arbitration Rules & Procedures Rule 15(i)

Rule 15. Arbitrator Selection, Disclosures and Replacement

* * *

(i) At any time during the Arbitration process, a Party may challenge the continued service of an Arbitrator for cause. The challenge must be based upon information that was not available to the Parties at the time the Arbitrator was selected. A challenge for cause must be in writing and exchanged with opposing Parties, who may respond within seven (7) calendar days of service of the challenge. JAMS shall make the final determination as to such challenge. Such determination shall take into account the materiality of the facts and any prejudice to the Parties. That decision will be final.