IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
NORFOLK DIVISION

MORPHO DETECTION, INC.,

Plaintiff,

v. **CIVIL ACTION NO. 2:11cv498**

SMITHS DETECTION, INC.,

Defendant.

OPINION AND ORDER

This matter is before the Court on Defendant Smiths Detection, Inc.'s ("Smiths") motion in limine to preclude Plaintiff Morpho Detection, Inc. ("Morpho") from presenting evidence or argument at trial of price erosion damages. ECF No. 170. The motion has been fully briefed and is ripe for decision. For the reasons discussed below, Smiths' motion in limine is **GRANTED**.

I.

Smiths' brief in support of its motion in limine states that "Morpho seeks price erosion damages based on its theory that it would have received in the 'but for' world a higher price for the sale of the Itemiser trace detection units it sold" to the United States Transportation Security Administration ("TSA"). ECF No. 212, at 2. Smiths further notes that the TSA awarded a contract to Morpho in 2009 for trace detection systems, and that pursuant to that contract, TSA issued four purchase orders between September 2009 and September 2010 for such systems. Id. at 3. The most recent of the four purchase orders, which was issued on October 9, 2010, provided for a specific number of units at fixed prices. Id. Most of these units were delivered prior to the filing of the complaint in this action on September 2, 2011. However, a small number of the units covered by the October 9, 2010 purchase order were delivered after September 2, 2011. Id.

Smiths argues that Morpho is limited by 35 U.S.C. § 287 (the marking statute) to recovering damages from September 2, 2011 to the present, and as a result Morpho cannot recover damages for Smiths' alleged infringement that occurred prior to the filing of the complaint on September 2, 2011. Id. at 4. Smiths further argues that as a result of the Court's laches ruling barring Morpho from recovering damages for infringements committed prior to the commencement of suit, ECF No. 253, at 28-30, any damages resulting from Smiths' pre-complaint activities are barred since Morpho waited more than six years to bring suit after having constructive notice of Smiths' allegedly infringing product. Id.

II.

Morpho responds that Smiths misunderstands the law and economics that govern the concept of price erosion. ECF No.

269, at 1. Morpho asserts that it seeks price erosion damages only for the damages accounting period – September 2, 2011 to present. Id. It argues that in "order to hypothesize the 'but-for-infringement' market during that period – that is, to determine how much higher [Morpho's] prices would have been, and how many units it would have sold – it is both necessary and logical to consider pre-accounting period prices, market conditions, and activities." Id.

Morpho goes on to argue that its expert, Jeffrey Kinrich, "hypothesized a market in which neither Smiths's infringing product nor any non-infringing alternative to [Morpho's] Itemiser DX detector was available. This necessarily led to the recognition that because [Morpho's] per-unit price would have been higher prior to the accounting period, TSA would have (at least in one hypothetical scenario) deferred purchasing some units until during the accounting period." Id. To support its theory that Mr. Kinrich can rely on pre-notice data to hypothesize how many detectors TSA would have purchased post-suit if no infringement existed, Morpho asserts that the "marking statute is concerned only with the infringing activities for which damages are recoverable, not the evidence or methods used to calculate those damages." Id. at pg. 2. Moreover, Morpho says that it is seeking price erosion damages "limited to the Itemiser DX detectors [Morpho] would have sold during the accounting period." Id. Finally, Morpho argues that laches is an affirmative defense that is irrelevant for purposes of the motion.

III.

Smiths replies that "Morpho does not dispute the fact that all of the Itemiser DX units on which the price erosion claim is based were sold to the TSA in firm-price contracts executed before September 2, 2011." ECF No. 290, at 1. Smiths also notes that "Morpho freely acknowledges that its damages expert's price erosion calculations are 'based on Smiths' infringing activity prior to the accounting period.'" As a result, Smiths concludes that "because all of the alleged infringement on which Morpho's price erosion claim is based (*i.e.*, Smiths' offers to sell the allegedly infringing IonScan 500DT to the TSA in competing contract bids) occurred when Morpho and Smiths competed for the TSA contracts prior to September 2, 2011, the Court should grant Smiths' motion." Id.

IV.

The parties have addressed multiple issues impacting the pending motion. While many are intertwined, the Court will attempt to address each of them separately.

A.

There is clearly a significant dispute within patent law as to "whether pre-notice data should be used in post-notice price erosion [damages] calculation . . . ." Symposium Review: The Shifting Sands of Price Erosion: Price Erosion Damages Shift By Tens of Millions of Dollars Depending Upon The Admissibility of Pre-Notice Eroded Prices, 25 *Santa Clara Computer & High Tech. L.J.* 723, 763 (2009). The above-referenced Symposium Review provides an excellent overview of the arguments supporting and opposing the use of such pre-notice data in proving post-notice price erosion damages, though it does not recommend one position over the other. The Court finds that the case against allowing pre-commencement data on prices to be used in calculating post-notice price erosion damages is stronger than the case for allowing such data to be used. Id. at 751 (summarizing the case against allowing pre-commencement data on prices to be used in calculating post-notice price erosion damages); see Power Integrations, Inc. v. Fairchild Semiconductor, Int'l, Inc., No. C.A. 04-1371-JJF, 2006 WL 2435084 (D. Del. Aug. 22, 2006); Johnson Elec. N. Am. Inc. v. Mabuchi Motor Am. Corp., 103 F. Supp. 2d 268, 280-81 (S.D.N.Y. 2000); see also Mformation Techs., Inc. v. Research in Motion Ltd., No. C 08-04990 JW, 2012 U.S. Dist. LEXIS 89421 (N.D. Cal. June 22, 2012). However, as Smiths notes in its reply brief, it is not necessary for the Court to actually reach that issue because of a significant difference between this case and the cases relied upon by Morpho. The Court agrees with Smiths.

B.

The cases upon which Morpho relies, as Smiths observes, "arguably support the proposition that a price erosion analysis may consider pre-damages period evidence (*e.g.* pricing information) to help determine the amount of damages resulting from infringement that occurred during the damages period." ECF No. 290, at 3. However, "there is an obvious and important difference between considering historical pricing and market information to determine the amount the patentee could have charged later, to account for damages caused by infringement occurring during the damages period (which is proper), and calculating damages for defendant's infringing conduct that occurred before the patentee complied with the marking statute (which is improper). Here Morpho seeks to do the latter, which is expressly prohibited by the marking statute . . . ." Id. In essence, Mr. Kinrich assumed that Morpho would have sold detectors during the post-notice accounting period by re-creating a hypothetical, but-for-infringement market. Kinrich then assumed Smiths was competing with Morpho for the post-notice hypothetical sales to TSA, thereby infringing. Kinrich then applied pre-notice data to these assumed/hypothetical post-notice Morpho sales and determined how many detectors Morpho would have sold, and at what price, but for Smiths hypothetical post-notice competition - the price erosion damages. Smiths argues that this turns the patent marking statute on its head, and the Court agrees.

The patent marking statute, 35 U.S.C. § 287(a), requires that patentees mark their products if they wish to recover damages for patent infringement occurring prior to the patentee giving notice of infringement to the infringer. The statute provides, in relevant part, as follows:

> In the event of failure so to mark, no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice. Filing of an action for infringement shall constitute such notice.

35 U.S.C. § 287(a)(emphasis added). Morpho concedes that Mr. Kinrich's opinion regarding price erosion damages is "limited to the Itemiser DX detectors [Morpho] would have sold during the accounting period." ECF No. 269, at 2 (emphasis added). According to Morpho, this effort to create post-notice sales by Morpho, and post-notice infringing competition by Smiths, where there were in fact neither, is ostensibly grounded in "re-creating a **hypothetical**, but-for-infringement market." Id. at 3. Notwithstanding the plain language of the marking statute, which the Court will discuss later, for a variety of reasons, Morpho suggests that patent law permits such damages. The Court will first address Morpho's effort to create a but-for scenario

that assumes post-notice sales by Morpho, as well as post-notice infringing competition by Smiths.

C.

The authors of the Law Journal article cited above discussed at some length the differences between reasonable royalty cases and price erosion cases. While their arguments focus on whether the reasons for allowing consideration of pre-notice data in reasonable royalty cases support doing the same in price erosion cases, such arguments are instructive to the situation before this Court - where Morpho argues that it should be able to use the but-for price erosion analysis to create hypothetical post-notice sales and hypothetical post-notice infringing competition. The Law Journal article addresses the differences as follows:

> While there is ample support for looking prior to notice for reasonable royalty calculations, there is little or no support for doing so for price erosion calculations. The distinction between the two is reasonable given their differing purposes. Price erosion is a type of lost profit calculation - which comes from a "but for" analysis - and is a measure of actual damages caused by infringement. In contrast, the reasonable royalty measure of damages is merely a "legal fiction." It is a last resort (floor) that patentees are allowed when they are unable to sufficiently prove any actual damages. The reasonable royalty is intended to be the amount "which a person, desiring to manufacture and sell a patented article, as a business proposition, would be willing to pay as a royalty." Thus, the negotiation must be assumed to be "between the patent owner and the prospective [user]." As such, "the key element in

> setting a reasonable royalty … is the necessity for return to the date when the infringement began."
>
> On the other hand, actual damages - which include price erosion - must be proven as the actual loss suffered by the patent holder as a "but for" result of the infringement. As stated above, the amount of damages recoverable is limited by statute to those incurred after notice is given. Pre-notice price erosion calculations assume that prices erode as soon as the competing infringing product enters the market. Thus, the premise is that the baseline as of the date of notice is lower than it would have been absent infringement. In other words, in order to recover, the patent holder has to prove that pre-notice infringement actually caused prices to erode during the pre-notice time frame. Therefore, allowing proof of pre-notice price erosion takes into account a loss that was incurred during the pre-notice timeframe, which is precisely what the marking statute forbids. As such, it is logical to limit the data used in a price erosion calculation to events occurring only after notice, while still using a pre-notice time frame for reasonable royalty calculations.

25 *Santa Clara Computer & High Tech. L.J.* at 754.

This argument is obviously addressed primarily to the situation where there are actual post-notice damages in a marking failure context, but a patentee seeks to use a reasonable royalty analysis to justify using pre-notice data in calculating such damages. Here, relying in part on reasonable royalty cases, Morpho seeks to use this same justification to use pre-notice data <u>and</u> to create hypothetical post-notice sales by Morpho, and hypothetical post-notice competition by Smiths, resulting in <u>infringement</u> by Smiths and <u>actual</u> damages for

Morpho in a marking failure context. However, the same reasons explained above militate against allowing a reasonable royalty analysis to justify Morpho's effort at "re-creating a **hypothetical**, but-for-infringement market" that <u>assumes</u> post-notice sales and infringement when none actually exists. As the article's discussion demonstrates, a proper but-for analysis occurs in the context of <u>actual</u> post-notice infringement. It asks, but-for the infringement, what would the market be for the product, and what would be the patent holder's actual lost profit damages. Here, there were no actual damages because Morpho's sales to the TSA, and Smiths competition with Morpho for these TSA sales, all occurred before notice - a time when Morpho is precluded by the marking statute from seeking damages. Therefore, there were no actual Morpho sales, and no actual infringing competition by Smiths for such sales. A lost profit analysis assumes a sale to which price erosion can apply so as to calculate the lost profit on the actual sale, it does not create the sale out of whole cloth and then apply price erosion analysis to a non-existent competing transaction. These reasons alone support the exclusion of the Kinrich opinion.

D.

The plain language of the marking statute also requires exclusion of the Kinrich opinion. The statute, 35 U.S.C. § 287(a), clearly states that damages cannot be recovered for infringement occurring prior to notice. Id. at 753. That is precisely what Morpho seeks to do by transforming pre-notice infringement (for which no damages are permitted) into post-notice infringement (for which damages are permitted) by using a but-for analysis. This would allow the specific language of the marking statute, 35 U.S.C. § 287(a), to be trumped by the patent law's general requirement for "full compensation." Grain Processing Corp. v. Am. Maize Prods. Co., 185 F.3d 1341, 1349 (Fed. Cir. 1999)(such full compensation language is grounded in the general language of 35 U.S.C. § 284 providing that "the court shall award the claimant damages adequate to compensate for the infringement"). This the law does not permit. Allowing such a construction violates the statutory canon providing that, if there is a conflict between a general provision and a specific provision, the specific provision prevails. This is generally expressed in the contextual statutory canon "generalia specialibus non derogant" - things general do not restrict (or detract from) things special. Morton v. Mancari, 417 U.S. 535, 550-51 (1974)("Where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment."). Accordingly, the plain and specific language of the marking statute prohibits using the general language of the damages statute to re-create a hypothetical but-for sales, competition, and infringement market where infringing sales are assumed to have taken place post-notice.

E.

The policy behind the marking statute also prohibits the creation of hypothetical but-for infringement where there is none. While in a different context, the authors of the Law Journal article expressed policy reasons why pre-notice data should not be considered in calculating post-notice damages in a failure-to-mark context. Id. at 755. These same policy reasons militate against permitting Morpho to create post-notice sales and infringing competition where there is none.

> The marking statute serves three related purposes: "1) helping to avoid innocent infringement; 2) encouraging patentees to give notice to the public that the article is patented; and 3) aiding the public to identify whether an article is patented." [Nike, Inc. v. Wal-Mart Stores, Inc., 138 F.3d 1437, 1443 (Fed. Cir. 1998).] In order to further these purposes, Congress structured the marking statute so as to tie failure to mark with the inability to collect damages prior to notice. [Am. Med. Sys., Inc. v. Med. Eng'g Corp., 6 F.3d 1523, 1537 (Fed. Cir. 1993).] These purposes strongly encourage patent owners to mark their products and promptly notify infringers if the product is not marked. It is in the best interest of society for companies to not spend the development and manufacturing costs on a product that they are not allowed to make. It is a waste of resources that the company could have used to make another product. It seems only fair that if the patent owner has an exclusive right to make and sell a particular item, the patent owner also has the responsibility to promptly notify infringers before unnecessary resources are wasted in the second company's production of the patented

> product. A company that allows unnecessary expenditures by the second company should, at the very least, be unable to recover damages during its time of inattention and carelessness.

Id. at 755.

As Smiths notes in its opening brief, "Morpho's attempt to recover price erosion damages based on Smiths' allegedly unlawful competition that occurred before Morpho complied with the marking statute is contrary to the purpose of avoiding innocent infringement. There is nothing Smiths could have done after being notified of Morpho's patent on September 2, 2011 to eliminate or mitigate Morpho's price erosion damages, since they were allegedly caused by Smiths' actions taken back in 2009." ECF No. 212, at 11. "[A]llowing Morpho to pursue price erosion damages in this case would punish Smiths for engaging in precisely the conduct (alleged pre-notice infringement) the marking statute is designed to protect." Id.

F.

The Court granted summary judgment of laches, barring Morpho from recovering damages for infringement committed prior to the commencement of the suit on September 2, 2011. ECF No. 253, at 28-30, Odetics, Inc. v. Storage Tech. Corp., 185 F.3d 1259, 1272-74 (Fed. Cir. 1999) (holding that where laches is established, the patent owner is precluded from recovering for all infringement by the infringer that occurred before the complaint was filed). As discussed in detail above, the post-notice infringements upon which Mr. Kinrich relies are hypothetical and are therefore grounded in pre-notice infringement - the recovery of damages for which are barred by laches.

V.

Because there was no actual post-notice sales or infringing competition during the damages accounting period upon which Morpho is relying for its price erosion calculations, there can be no damages based upon such assumed price erosion. Smiths' motion is therefore **GRANTED**. ECF. No. 170.

The Clerk is **REQUESTED** to send a copy of this Opinion and Order to all counsel of record.

It is so **ORDERED**.

/s/ MSD

Mark S. Davis
United States District Judge

Norfolk, Virginia
December 3, 2012