Daily Journal

EXTRA

January 12, 2004

Trials, transactions and the insider's guide to the practice of law.

Supplement to the Los Angeles Daily Journal and San Francisco Daily Journal

CHECKMATE

Daniel Callahan Flipped A Breach Of Contract Case on Its Head Last Summer, Adding Two Unsual Claims That Netted His Cleint $934 Million And Secured His Stake To The Largest Verdict In The State Last Year.

USUAL SUSPECTS

BY STEFANIE KNAPP

Forget Big Tobacco, high-stakes intellectual property cases or corporate fraud, California's largest verdict in 2003 came from a breach of contract case when Daniel Callahan's added claims for economic duress brought his client nearly a billion dollars. Insurers, doctors and gunmakers all wound up on the hook for some of the top 10 jury awards last year.

1 Daniel Callahan was transfixed by Judge Gregory H. Lewis.

Specifically by his mouth, which seemed to be moving in slow motion.

The lawyer had spent 10 weeks with his associate, Brian J. McCormack, battling for their client, Beckman Coulter Inc., in the courtroom of the Superior Court judge. And, it seemed, time had ground to a halt between each small movement and twitch of the Orange County judge's lips.

Callahan stared as the lips parted and the words "two point one million" issued forth.

The jury had found Flextronics International responsible for breaching a contract with Beckman.

"It was exactly the number I told them," Callahan says.

He hadn't a moment to celebrate, however, because, again, his quarry was on the move.

"Three hundred fifty-five thousand," in compensatories, the lips said, followed by "one point four million dollars" in punitive damages for concealment and fraud.

Callahan knew he was right on track, with the big claims to come.

The lips began to move on the third cause of action, economic duress, with which the fourth claim could go as high as $1.2 billion. Callahan felt lost.

For luck, he returned his gaze to the judge's lips.

"I couldn't look away," Callahan of Santa Ana's Callahan & Blaine says.

Time crawled.

Callahan had asked for $135 million in punitive damages for the third cause of action, and slowly, the words "one hundred" eked forth.Callahan thought to himself, "Oh, man, give me the $135 million," as paragraphs and paragraphs of thought went through his mind."... and eighty million dollars," the judge finished.

Callahan turned and winked at the Beckman Coulter representatives in the courtroom, before returning his attention to the lips.

The fourth cause of action was another claim for economic duress, and the jury found potential economic harm in the amount that Callahan sought, $295.7 million.

Callahan knew he had scored. Big. So when the judge began to read the punitive-damages award, he figured his pay dirt had been unloaded.

"Seven hundred fifty," the lips uttered.

"Of course now I know he's going to say thousand," Callahan said, "and I'm thinking, 'All right, great.'""... million," the judge finished.

Neither Callahan nor the defense attorneys, Scott Ferrell, of Newport Beach's Call, Jensen & Ferrell, and Gary Waldron, of Waldron & Olson in Newport Beach, could believe their ears.

"You should have heard [Ferrell] and [Waldron's] sighs when they heard that one," Callahan says.

Waldron admitted that he was "extra-ordinarily" surprised at the verdict.

The jury awarded Beckman Coulter a total of $931 million in punitive damages and $3 million in compensatory damages in the case.

The award landed Callahan the largest California plaintiffs' verdict in 2003 and the second-largest in the country, behind an $11.9 billion award won by Alabama on Nov. 14 against Exxon for failure to pay the state natural-gas royalties.

Callahan later settled the Beckman case for $23 million. But the original verdict places him atop the list of Daily Journal Extra's top 10 plaintiffs' verdicts handed out by a jury in 2003. *Beckman Coulter Inc. v. Dovatron International Inc.* 01CC08395 (Orange County Super. Ct., verdict Sept. 24, 2003).

The case started as a simple breach-of-contract case, which Callahan would have settled for $750,000 before trial. Six weeks into the trial, Callahan realized he had an economic-duress case on his hands. One week later, on Aug. 21, Callahan amended the complaint to add the claim, the civil equivalent of extortion and a subspecies of fraud, according to Callahan.

"We had no prepared defense to that," Waldron says. "We didn't expect that to be allowed in."

Waldron requested more time to prepare a defense to the motion, but the judge denied that request.

Both sides agree that it was the turning point in the case.

Adding the economic-duress claims turned the case into a near billion-dollar win for Beckman Coulter, netting $931 million of the $934 million verdict.

"That was a good decision to make, I'd say," Callahan says.

The case arose from a five-year agreement that began in 1997, in which Dovatron International Inc. agreed to produce circuit boards for a blood analyzer that Beckman Coulter sold to hospitals and clinics.

In 2000, however, Flextronics purchased Dovatron and shut down its Anaheim facility, which produced the circuit boards for Beckman Coulter. Flextronics disengaged Dovatron from the five-year contract.

That created serious problems for Beckman, which had searched for a circuit-board producer for one year and gone through a 10-month validation process with the Food and Drug Administration to gain approval to put the circuit boards in a medical device. When Flextronics shut down the plant, it gave Beckman Coulter just 90 days' notice.

Callahan claimed that Flextronics knew Beckman would need at least another year to find a new circuit-board producer. Beckman Coulter would have lost $135 million in profits during that process, according to Callahan.

Beckman Coulter filed its complaint on June 28, 2001, alleging breach of contract, as well as fraud in the inducement. Beckman Coulter alleged in the fraud-in-the-inducement claim that, to get the contract, Dovatron made false representations about its capabilities and the staff needed to produce the circuit boards.

Beckman Coulter hired Callahan to bring its lawsuit because he had worked for them in the past. His partner, Stephen Blaine, headed the discovery and pleading stages, and Callahan took over in May 2003 to run the trial.

After reading through stacks and stacks of depositions, Callahan discovered that a Dovatron manager, Steve Howard, forced Beckman Coulter to pay a surcharge of $300,000 for a shipment of parts in 1998 that Dovatron received, which Howard alleged were useless, according to Callahan.

Howard told Beckman Coulter that, if it did not pay the surcharge, Dovatron would not supply any more circuit boards to Beckman Coulter, according to Callahan. Beckman reluctantly agreed. Dovatron added a small fee onto the price of the circuit boards until the $300,000 was paid, according to Callahan. But even after the surcharge was paid, Dovatron didn't remove the small fee. Instead, it kept charging Beckman Coulter, which ended up paying $355,000 in addition to the $300,000, according to Callahan.

Howard's deposition testimony convinced Callahan to drop the fraud-in-the-inducement claim and instead focus on claims of fraud and concealment. He believed that the fraud in the inducement would be too difficult to prove, but he could prove pretty clearly the fraud and concealment claim with testimony of witnesses and a few documents, according to Callahan.

"I didn't want this fraud in the inducement clouding up this beautiful little fraud I had here," Callahan says.

Waldron argued that, because the alleged fraud occurred in 1998 but was not added to the lawsuit until 2003, the claim violated California's three-year statute of limitations.

The addition of that claim got Callahan and Beckman Coulter actual damages of $355,000 plus $1.4 million in punitives on the fraud claim.The trial began in July. One thing that Callahan wanted the jurors to understand in jury selection is that they were going to be dealing with big bucks, and he wanted to be sure that they would be willing to award large damages if necessary.

The more Callahan listened to the witnesses and reviewed the cases, the more he believed that what had happened was extortion, which was covered under criminal rather than civil statutes.

His problem was that he was in a civil trial. And he didn't know for sure whether extortion had a civil counterpart, but he thought that there had to be one. Six weeks into trial, Callahan asked one of his associates, Marc Miles, to find it. Miles researched in the firm's library and computers. Callahan also asked Michael Sachs to see what he could come up with.

An hour later, Sachs & Miles came back with a theory of economic duress. Sachs gave the information to Callahan, who turned it over to Miles to draw up the motion to amend the complaint.

Economic duress hadn't been used much as a tort, but Callahan felt strongly that he would prevail and get it admitted by the judge. It is recognized as a tort in other states and has been recognized in California when considered under a three-year statute of limitations.

However, Waldron disputes the claim.

"We don't believe there is a right to tort damages for economic duress," he said.

Callahan saw economic duress arising in two places. The first was in 1998 when Howard ordered that Beckman Coulter pay an additional $300,000 to Dovatron; the second came in 2000 when Flextronics forced Beckman Coulter to buy additional inventory to get back the components it had purchased from another supplier but was housing at Dovatron.

At that time, Flextronics housed components that Beckman Coulter needed for the production of the circuit boards. Beckman Coulter had purchased a large number of the components from the manufacturer, who had notified Beckman Coulter that it no longer would be making the part, according to Callahan.

But when Beckman Coulter tried to collect the components that it owned, Flextronics manager Terry Zale told Beckman Coulter that, to get the inventory, the company also would have to purchase a number of other items that Flextronics had left over from other customers, according to Callahan.

"He basically took a broom out in his warehouse and said, 'You've got to buy everything I sweep up here if you want to get your lifetime buys,'" Callahan says.

Beckman Coulter agreed and paid $198,265 to get back the inventory to which it had a contractual right, Callahan says.

After Flextronics shut down the Anaheim plant, Beckman Coutler brought the production of the circuit boards in-house. Waldron argued that Beckman Coulter was not entitled to damages under California law because it brought that production in-house.

Under the Commercial Code, if company A produces goods for company B and then stops that production, company B is supposed to go out into the marketplace and find an alternate supplier.

"The Uniform Commercial Code has no provision in it that allows the customer to manufacture internally instead of going out and buying from another source," Waldron says.

Ultimately, the Court of Appeal would have had to decide whether the claim was well founded, according to Waldron.

"Obviously, it was a creative and somewhat brilliant strategy on [Callahan's] part, but it was appropriate," says Harvey Levine, plaintiffs' attorney at San Diego's Levine, Steinberg, Miller & Huver, referring to Callahan's amending the complaint seven weeks into trial.

Levine also noted that Callahan was very mindful of the April 2003 U.S. Supreme Court decision in *State Farm Mutual Automobile Insurance Co. v. Campbell,* 2003 DJDAR 3783 (U.S. April 7, 2003). That decision said a single-digit ratio of compensatory to punitive damages should be used when awarding punitive damages.

The ratio that the lawyer recommends allows the jury to include findings of potential economic harm when calculating punitive-damages awards, according to Levine, which is why Callahan was able to obtain the large punitive damages that he did.

But Gibson, Dunn & Crutcher partner Ted Boutrous disagrees. Boutrous believes that *State Farm* made it clear that potential economic harm cannot be included in determining punitive damages.

"[It was] clearly an unconstitutional punitive-damages award," says Boutrous, who specializes in overturning large punitive-damages awards.

Many including Boutrous believed that the verdict would have been reduced severely if it went up on appeal. One of the big problems Boutrous and other lawyers saw with the case was the judge's decision to allow Callahan to amend the complaint seven weeks into trial.

"A defendant must have fair notice," Boutrous says. "If you don't find out until the middle of the trial, that means that the defendant didn't have time to prepare a defense."

But the jury saw bigger problems than the amended complaint. They had a hard time believing Flextronics' witnesses, according to juror Shawn Allston, 41, of Anaheim.

"All the people they brought in to testify ... they weren't credible," Allston says.

Allston thought that many of the witnesses were "just straight out lying."

And while the attorneys for both sides believed that the amended complaint was the turning point in the trial, Allston remembers another day as a pivotal one.

"Flextronics came out in court [and said] that they could afford to pay any amount of punitive damages that was allowed by law," Allston, one of the jurors, says.

That stipulation was read in court by Lewis on Tuesday, Aug. 19, 2003.

At that time, any damages were expected to be in the single million-dollar range, and there was no question that Flextronics, whose worth was in the multibillions, could pay those damages, according to Waldron. He thought that it made no sense for the jury to hear testimony concerning the net worth of the company, when it was undisputed that the company could pay the damages, Waldron says. So he agreed to the stipulation being read in order to stop further testimony about Flextronics' financials, according to Callahan.

While Waldron claims that releasing such a stipulation had been under discussion since the beginning of trial, it occurred four days after the testimony of Jim Skorheim, of Moss Adams, a Newport Beach accounting firm. On Friday, Aug. 15, Skorheim explained to the jury that, in order for the board of directors to notify the shareholders and amend its financial statement, the award would have to be at least $45 million, or 1 percent of the company's net worth, according to Callahan.

"The plaintiff thought to introduce through Skorheim information concerning punitive damages into evidence, but at that time the complaint had not been amended and the issue of potential harm for punitive damage purposes was not an issue in the lawsuit," Waldron says.

After Lewis read the stipulation Allston thought the trial was over.

"But it went on for another four weeks," he said.

In fact, the trial was just getting started. Two days later, Callahan filed the amended complaint adding the economic-duress claims. And Callahan didn't let the stipulation regarding Flextronics' ability to pay any punitive-damages award go unnoticed. He used that statement to prove his theory that Flextronics only "worshipped at the altar of the almighty dollar" and had no regard for the health and safety of the American public.

Callahan wanted the jurors to feel comfortable with the big numbers in this case and to "get outside their own checkbooks."

So in his rebuttal, he laid down one hundred singles on the table.

He asked the jury to imagine someone who had done something as bad as Flextronics in this case and to imagine that the jury had to punish that person. He reminded the jury that the purposes of punitives are to punish and to deter conduct.

Callahan told the jury to imagine that this person has $100. He picked up one of the singles — 1 percent of the total on the table — and held it up.

"Do you suppose if you took one dollar away and left him with $99 that would punish and deter the person?" Callahan recalls saying.

He snapped the one-dollar bill and said, "This is $45 million to Flextronics."

He says he again told the jury that they were dealing in a whole different world, one of two multibillion-dollar companies and that, "to send a message, you have to deal with real numbers."

The jury deliberated for $2^1/_2$ days. On Sept. 23 at 2:30 p.m., while Callahan was in the court cafeteria eating lunch, he got a call to report to Lewis' courtroom. When he entered, Lewis was handling another matter, but at 2:35 p.m., he told Callahan and Waldron that the jury had reached a verdict.

Callahan asked the judge to delay the reading of the verdict until the following day so that the alternate jurors could come back for it. All 16 jurors had endured the trial, and he believed that the four who were left out of deliberations should be present for the verdict, as well.

The judge agreed, and the verdict was read Sept. 24.

The courtroom was packed with representatives of Beckman Coulter and Flextronics, as well as Callahan's colleagues, girlfriend, Maureen Baur, and children, Caitlin Callahan and Michael Callahan.

Callahan felt good about the case going into the trial, so good in fact that he had invitations to a barbecue at his house printed up to give to the jurors after the reading. The party was planned for that Saturday.

As the judge finished reading the verdict, Callahan looked back to Bill May, Beckman Coulter's general counsel, and his jaw was virtually on the ground, Callahan says.

"He could not believe his ears," Callahan says. "Everyone of them was just in shock."

He went back among the spectators, hugged his girlfriend and kids, shook hands with Beckman Coulter representatives and bowed to May. It was May's idea to go after punitive damages, according to Callahan.

He returned to McCormack and said, "Get out the invitations."