

Nos. 05-16380 and 05-17059

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT**

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**G. CLINTON MERRICK JR.,**

**Plaintiff-Appellee,**

**v.**

**THE PAUL REVERE LIFE INSURANCE COMPANY; a Massachusetts corporation, UNUMPROVIDENT CORPORATION (d/b/a UNUM LIFE INSURANCE COMPANY OF AMERICA and PROVIDENT LIFE AND ACCIDENT INSURANCE COMPANY); and DOES I through X inclusive, and ROES I through X, inclusive,**

**Defendants-Appellants.**

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**On Appeal From The United States District Court  
For The District Of Nevada, No. CV-S-00-0731-JCM**

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**APPELLANTS' REPLY BRIEF**

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**I. DEFENDANTS SHOULD BE GIVEN A NEW TRIAL ON BAD FAITH AND PUNITIVE DAMAGES.**

Merrick is correct that defendants waived the right to seek JMOL. In our opening brief, we incorrectly labeled as a JMOL argument what should have been presented as a new-trial argument (which defendants did preserve below). Because the new-trial argument involves the same issues, Merrick has responded to those issues, and only the standard of review is different, defendants ask the Court to consider their arguments under the new-trial standard. *See Desrosiers v. Flight Int'l*, 156 F.3d 952, 957 (9th Cir. 1998) (*sua sponte* considering argument under new trial standard because JMOL had been waived).

Defendants recognize that the denial of a new-trial motion may be reversed only if the district court committed a “clear abuse of discretion.” *Id.* Even under this strict standard, however, defendants are entitled to relief.

**A. The Denial Of Merrick’s Claim Did Not Constitute Bad Faith.**

Merrick admits that defendants cannot be guilty of bad faith if they had a reasonable basis for denying his claim (Answering Brief (“AB”) 24) and acknowledges that his eligibility for benefits turned on whether he suffered from disabling mental and physical impairments (AB26). Nevertheless, he fails to address *any* of the extensive evidence of his functional abilities described in our opening brief (at 5-16, 20-25). He also fails to identify any evidence that he was

unable to perform his important job duties, aside from his self-report.<sup>1</sup> Because Merrick has failed to impugn the consistent psychological and physical evidence of normal functioning upon which defendants' decision was based, he has failed to make a case for bad faith, let alone punitive damages.

Instead of responding to the overwhelming evidence that he was functioning normally, Merrick raises five other grounds that he claims warrant a finding of bad faith. Each is baseless.

1. Merrick contends that "there had been no change to [his] claim that could explain" defendants' decision to deny it after paying it for two years. AB15; *see also* AB13, 26-27. That assertion is flatly false. When defendants first paid Merrick's claim, on April 3, 1995, the only documentation in the claim file was notes from Merrick's treating physicians, Drs. Rapaport and Epstein. Merrick's claim had not even been reviewed by defendants' internal medical consultants.<sup>2</sup> It

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<sup>1</sup> Merrick claims that his rheumatologist, Dr. Mushlin, "concluded [that] Merrick was 'unable to work at his job'" based on "extensive testing." AB4. But this "extensive testing" consisted of a physical examination that was "entirely normal" and thirty deep-knee-bends that "did not cause undue fatigue." EX174:70-71. Furthermore, Dr. Mushlin did *not* reach any conclusion regarding whether Merrick was able to work; he merely repeated the history given to him by Dr. Epstein. *See id.*

<sup>2</sup> Merrick's suggestion that defendants paid his claim "[a]ccording[]" to their medical consultant's review (AB6) is misleading in two respects. First, the review occurred two weeks *after* defendants began paying Merrick's claim. EX174:174. Second, although the consultant thought that Merrick might have significant impairments due to depression, when asked "what are [Merrick's] limitations," he observed that Dr. Silber from the Mayo Clinic had advised Merrick to return to

was only after defendants had begun paying Merrick's claim that the evidence began to arrive:

- On April 4, 1995, defendants received the Mayo Clinic report, which found no significant psychological or physical impairments and recommended that Merrick return to work.<sup>3</sup> *See* FER1-4.
- On June 21, 1995, defendants learned that Merrick was trying to start another venture capital firm. ER106-07.
- Dr. Donaldson's IME was conducted in December 1995. ER125-29.
- In May 1996, Dr. Rapaport was unable to identify any empirical basis for his certification of Merrick's total disability. ER132-33.
- And, in August 1996, defendants received Dr. Frohwirth's May 1994 report, which contained normal psychological test results and expressed skepticism about Merrick's motives. ER134-38.

Thus, on September 12, 1996, when defendant's internal medical consultant concluded that "there does not appear to be any neuropsychologically-based disability" (ER138), a great deal had changed since defendants began paying Merrick's claim.

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work, and he indicated that further information was needed. FER3. Merrick also misleadingly quotes a management referral's reference to this initial review (at AB14, 27), omitting the referral's conclusion that Merrick's "cognitive impairment does not warrant T[otal] D[isability]" (EX174:544).

<sup>3</sup> Merrick mistakenly claims that Dr. Silber's advice to reduce his stress level and lower his time commitment amounted to total disability. *See* AB27 & n.4. The federal district court opinion he cites for this proposition has been abrogated by more recent Massachusetts case law and First Circuit precedent holding that an insured is not "totally disabled" if he can work part time in his occupation or perform some, but not all, of the important duties of his occupation. *See* Opening Brief ("OB") 3-4.

Merrick also contends that, “when Defendants denied the claim, there were no doctors ... expressing the opinion that Merrick could do his job.” AB15 (alteration and quotation marks omitted). This statement too is false. Dr. Ivnik had concluded that Merrick “may want to pace himself and work carefully when stressed but I would not predict major problems in daily living or working.” ER69. Dr. Silber advised that Merrick “restart work.” ER76, 92. Dr. Donaldson concluded that Merrick “does not have ... an active neurological problem.”<sup>4</sup> ER128. And, after reviewing all evidence in the file, defendants’ internal consultant, Dr. Cusher, concluded that “there does not appear to be any neuropsychologically-based disability.” ER138.

2. Merrick contends that defendants are guilty of bad faith because they denied his claim based on the objective evidence of his functional abilities, rather than accepting his self-reports, even though “Merrick’s policy does not require ‘objective evidence.’” AB14-15; *see also* AB27-31. But, without a focus on objective evidence, the review of claims would be “meaningless because [the insurer] would have to accept all subjective claims of [the insured] without question.” *Williams v. Unum Life Ins. Co. of Am.*, 250 F. Supp. 2d 641, 648 (E.D.

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<sup>4</sup> Dr. Donaldson thought that Merrick might need treatment for bipolar disorder (ER128-29), but both Merrick (ER144) and Dr. Rapaport (ER133) insisted that Merrick did not have a psychiatric condition, let alone one that disabled him. Thus, the consultant’s recommendation to ask Dr. Donaldson whether he thought that Merrick needed psychotherapy (*see* AB29 (citing EX174:277)) was rendered moot.

Va. 2003). Accordingly, courts uniformly have held that, whether or not an insurance policy explicitly requires “objective evidence,” an insurer is entitled to deny a claim based on objective evidence that contradicts subjective self-reports. *See, e.g., McGee v. Reliance Standard Life Ins. Co.*, 360 F.3d 921, 924-25 (8th Cir. 2004); *Nichols v. Verizon Commc’ns, Inc.*, 78 F. App’x 209, 212 (3d Cir. 2003); *Roach v. Prudential Ins. Brokerage, Inc.*, 62 F. App’x 294, 299 (10th Cir. 2003); *Lown v. Continental Cas. Co.*, 238 F.3d 543, 549 (4th Cir. 2001); *Williams*, 250 F. Supp. 2d at 648; *Short v. Unum Life Ins. Co. of Am.*, 2003 WL 22937720, at \*10 (D. Conn. Dec. 3, 2003); *Maniatty v. UnumProvident Corp.*, 218 F. Supp. 2d 500, 504 (S.D.N.Y. 2002), *aff’d*, 62 F. App’x 413 (2d Cir. 2003); *Bailey v. Provident Life & Accident Ins. Co.*, 2000 WL 33980014, at \*4 (N.D. Fla. June 13, 2000).

Merrick also asserts that there was ““objective medical evidence”” that he had CFS (AB14), but it is undisputed (*see* AB26) that “total disability” under Merrick’s policy turns on an assessment of his functional abilities, not his diagnosis (*see* OB3-4). And, with regard to the psychological and physical conditions that Merrick said were disabling him, the objective evidence consistently indicated normal functioning. *See* OB5-16.

3. Merrick contends that a field representative offered to “buy out” his claim, and then, after Merrick declined, left him a “trick” monthly benefit check that would have settled the claim anyway. AB13-14. As previously discussed

(OB8-9), the field visit and offer of a four-month recovery benefit (ER116-17), which is not a buy-out or settlement, were prompted by information that Merrick was trying to start a new venture capital firm (ER106-07)—*i.e.*, work in his occupation. And the monthly benefit check—which Merrick recognized was intended to be “the June payment” (ER122)—said on its face that it was “Partial” payment of Merrick’s claim (ER123; *see also* ER124).

4. Merrick contends that the second field-representative visit, over a year later, was evidence of bad faith because defendants asked that it be done on a “rush” basis and because the field representative “threatened to sue Merrick for already paid benefits.” AB13-14; *see also* AB28-29. But Merrick ignores that defendants’ request to handle his claim on a “rush” basis was prompted by their medical consultant’s recent conclusion, based on all the evidence in the claim file, that Merrick was not totally disabled. *See* OB11, 32; ER136-38. Because defendants were prepared to deny the claim unless new evidence proved Merrick’s disability—as they told Merrick when they offered to settle his claim (EX174:524)—there was nothing improper about wanting to quickly discontinue paying benefits that were not owed. Yet notwithstanding that perfectly permissible motivation, defendants, acting in good faith, continued paying Merrick’s claim while they waited for the QEEG results. *See* ER145-47; ER153 (denying claim in January 1997).

The only evidence of an alleged “threat to sue” was Merrick’s trial testimony; neither the claim handler (ER141-42, EX174:524) nor Merrick (ER143-46) mentioned such a comment in their contemporaneous statements. Regardless, because defendants had concluded that the evidence did not support a claim that they had been paying for two years, it would have been completely appropriate to admonish Merrick that they could sue him if they were to discover that his claim was fraudulent.

5. Finally, Merrick invokes defendants’ failure to change their decision based on the reports from Drs. Cheney and Sandman. AB15-16; *see also* AB29. Once again, he ignores the evidence and makes no effort to show that defendants were acting unreasonably when they concluded that: (i) Dr. Cheney’s report contained no new evidence of Merrick’s functional abilities (*see* OB13-14, 24), and (ii) Dr. Sandman’s testing showed that Merrick was functioning normally, with the exception of one obscure test that further investigation revealed to be bogus (*see* OB14-15, 25).

In sum, there is no evidence that defendants acted unreasonably in handling Merrick’s claim.

**B. The “Bad Company” Evidence Does Not Prove Bad Faith Here.**

Although Merrick devotes seven pages of his brief to his expert’s “bad company” testimony (AB7-13), he raises only two aspects of that testimony when

describing his own claim: the allegedly improper focus on objective evidence and the “scrub concept” (AB13-16). As already noted: (i) the law fully supports an insurer’s reliance upon objective evidence (*see* pages 4-5, *supra*), and (ii) as is evident from the documentation in the claim file, each stage of defendants’ claim-handling was explicitly and reasonably guided by the evolving evidentiary picture, not an arbitrary “scrub concept” (*see* pages 5-7, *supra*).

**C. There Is No Evidence Supporting Punitive Damages.**

As shown above, Merrick’s characterization of defendants’ claim handling is grounded in rhetoric, not facts. Even if his allegations are sufficient to create an inference of bad faith, they do not meet the heightened standard required for punitive damages: clear and convincing evidence of oppression, fraud, or malice.

**II. THE DISTRICT COURT ERRONEOUSLY EXCLUDED IMPORTANT EVIDENCE.**

**A. Defendants Did Not Withhold Any Information.**

Merrick says that the district court had “[a]mple [g]rounds” to sanction defendants for withholding documents. AB42-43. But neither of the “grounds” he identifies has any basis in fact.

First, Merrick claims that the magistrate’s holding that defendants had forfeited their privilege with respect to any responsive documents that were not listed in a privilege log “necessarily implies that Defendants had been withholding documents.” AB34-35. He is mistaken. The only conclusion that the magistrate’s

order “necessarily implies” is that *if* defendants had been withholding responsive documents under a claim of privilege—contrary to their consistent representations (ER469-70, 488-93, 509-10)—then the privilege was forfeited. *See generally* OB38-39.

Second, Merrick suggests that defendants “acknowledged to Judge Mahan that privileged documents exist.” AB35 (emphasis omitted). But the fragmentary statement that he quotes, interrupted mid-sentence by the district court, says nothing about responsive documents being withheld. *See* ER516. Regardless, in a written submission filed immediately after this hearing, defendants clearly stated that:

**Defendants did not withhold any documents responsive to Plaintiff’s discovery request on the basis of privilege.** Defendants produced to Plaintiff the entire claim file, including the entire ‘post-litigation claim file.’ The only Court Order relevant to this discovery dispute was an Order stating that any privileges not asserted in a privilege log were waived. Because no documents responsive to Plaintiff’s discovery requests were withheld from production, no privilege log was produced.

ER488 (emphasis in original). *See also* ER489-91 (describing discovery history); ER492-93 (declaration under penalty of perjury).<sup>5</sup> Merrick has provided no reason to presume that this representation was a fraud on the court.

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<sup>5</sup> Contrary to Merrick’s assertion (AB40), defendants did *not* continue to assert privilege after the magistrate’s order. The passage Merrick quotes in bold (*id.*) is from defendants’ *initial* discovery response (ER448-50). Indeed, defendants had produced all responsive documents *before* the magistrate’s order, which is

We already have described the history of defendants’ post-litigation claim handling and shown that defendants produced all responsive documents. OB34-37. Merrick speculates that defendants withheld “notes and other documents reflecting the thought processes behind internal decision-making (*e.g.*, notes of conversations with medical experts, notes concerning referrals to medical experts, etc.).” AB39-40. ***But there are no such documents.*** All medical information that defendants obtained after litigation was reviewed by Drs. Cusher and Kaplan, each in a single written report. *See* ER455-65, 473-74. Because neither doctor found any evidence that Merrick was totally disabled, there was no reason for defendants to reconsider Merrick’s claim. There are no other “documents reflecting ... thought processes,” “notes of conversations,” “notes concerning referrals,” or any other responsive documents.<sup>6</sup>

Finally, Merrick accuses defendants of giving their internal consultants only “certain selected documents” in an “effort to ‘pad’ the claim file.” AB41. But he fails to identify even a single relevant document that was withheld from Drs. Cusher and Kaplan. As we already have explained (OB35-37), Drs. Cusher and

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why there was no new production, and no assertion of privilege, afterward (*see* AB41).

<sup>6</sup> Contrary to Merrick’s assertion (AB39), Nev. Admin. Code 686A.675(3) does not require 30-day-updates whenever a claim is under investigation, but only when an insurer has failed to render a decision on the claim within the regulation’s 30-day period after the proof of loss.

Kaplan reviewed *all* of the new medical information that defendants obtained after litigation.

**B. This Issue Was Preserved.**

Merrick says that defendants waived this issue by failing to offer each piece of evidence at trial. AB37-38. But “[o]nce the court makes a definitive ruling on the record ... a party need not renew an ... offer of proof to preserve a claim of error for appeal.” FRE 103(a). Here, at the pre-trial hearing, the district court told the parties that, “if what [Merrick’s counsel] tell me [about withheld documents] is true, I’m going to grant the motion.”<sup>7</sup> ER520-21. Then, during a protracted colloquy on the first day of trial (ER535-51), the district court definitively ruled on this sanction and excluded specific documents.<sup>8</sup> *See, e.g.*, ER540 (the Northwestern Mutual file: “That’s out.”); ER543 (Drs. Cusher’s and Kaplan’s reviews: “[T]hat’s out.”); ER548 (“[defendants] can’t use ... anything of their claims file [after litigation] that was for the claims file [as opposed to for litigation]”). Defendants were not required to engage in the futile exercise of offering evidence that had been definitively excluded as a sanction.

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<sup>7</sup> Merrick’s other contention at this hearing—that defendants had failed to appear for a deposition (ER503-21)—was subsequently proved to be false and played no role in the district court’s ruling (ER535-51).

<sup>8</sup> The district court also held that evidence of events that “happened before the litigation” but that defendants “didn’t discover until afterwards” would be allowed (ER544), which is why, as Merrick observes (AB38), late-disclosed notes from his doctors were admitted without objection (12/6 187-88).

### C. Merrick's Other Arguments Are Meritless.

Attempting to make this issue appear more complex than it is, Merrick observes that he filed three motions in limine objecting to various pieces of the excluded evidence on various grounds (AB35-37) and then implies that this Court must address those “numerous other grounds” as possible support for the district court’s order (AB43-46).

But the district court excluded this evidence for one reason—as a discovery sanction. *See* ER544-45 (“[W]hat I’m concerned about was the unfairness to you [Merrick] that they say we aren’t going to turn over our claim file, and yet we’ll turn over the bits and pieces we want to, and it’s incomplete. That’s all.”); *see generally* ER535-51. Indeed, the district court explicitly rejected many of Merrick’s other arguments. *See, e.g.*, FER12-13; ER538-44, 548-49. Because the justification for excluding these documents wholesale as a discovery sanction was erroneous, undecided document-by-document questions of admissibility should be decided, in the first instance, by the trial court on remand.<sup>9</sup> *See, e.g., United States v. Peters*, 937 F.2d 1422, 1427 (9th Cir. 1991) (“Because the district court improperly excluded [evidence] on the basis of asserted discovery violations, it never exercised its discretion concerning admission of the [evidence].

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<sup>9</sup> The case Merrick cites (AB37)—*United States v. Cantrell*, 433 F.3d 1269 (9th Cir. 2006)—deals only with criminal sentencing and is thus inapposite here.

Accordingly, ... we remand to the district court for a determination of that issue.”).

Regardless, none of Merrick’s alternative bases for excluding this evidence has merit.

First, Merrick complains that the documents should have been excluded as irrelevant hearsay. AB43-45. But as evidence of defendants’ claim handling they were not hearsay and were no different than the other medical reports and reviews in the admitted portion of the claim file (*e.g.*, reports from Drs. Cheney, Sandman, Frohwirth, and previous reviews from Drs. Cusher and Kaplan).<sup>10</sup> And Merrick’s suggestion that these documents were irrelevant to an analysis of defendants’ claim handling (AB44) is belied by his own expert, who emphasized that insurers must consider new information obtained during litigation (ER573-74)—testimony that clearly influenced the jury (*see* OB45 n.17).

Second, Merrick contends that introducing the documents from Northwestern Mutual’s file would have required “a mini-trial” on his Northwestern Mutual claim and would have been prejudicial because Northwestern Mutual used different policy language and eventually settled the

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<sup>10</sup> Contrary to Merrick’s implication (AB45-46), defendants have not argued that the documents themselves should have been admitted through their expert, but only that he should have been allowed to discuss and rely upon them when rendering his opinion (*see* OB40 n.15). The documents themselves should have been admitted along with the rest of defendants’ claim file. *Id.*

claim (AB45). But the district court appropriately rejected this argument with respect to the medical reports: “[A]ll that’s relevant [is that] Dr. Et[c]off examined him. Who retained Dr. Et[c]off? I don’t care. ... It doesn’t matter. Here’s what Et[c]off found.” FER12-13. Merrick’s argument is relevant to, at most, Northwestern Mutual’s two denial letters (ER343-44, 373).<sup>11</sup> The erroneous exclusion of medical reports from Drs. Etcoff, Athelston, and Novom, not to mention the C-Mind data and defendants’ own reports from Drs. Cusher and Kaplan—none of which implicate the Northwestern Mutual claim—is more than sufficient to warrant a new trial, even if the two denial letters were properly excluded.

Finally, Merrick’s suggestion that Dr. Sandman’s normative data were cumulative because defendants already had criticized Dr. Sandman’s results (AB46) is meritless. When Merrick filed this lawsuit, defendants still were trying to obtain this data to complete their review, but Dr. Sandman and Merrick were resisting. *See* OB14-16, 40. It was only after defendants issued a subpoena, post-litigation, that they finally received this information and were able to complete their review of Merrick’s claim. *See id.* In addition to tying up this loose end in the claim file and demonstrating good-faith claim handling, the excluded data

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<sup>11</sup> Even the reports of Northwestern Mutual’s medical consultants (ER345-46, 374) focus on assessing the medical evidence rather than claim-handling outcomes.

would have been the only evidence proving that Dr. Sandman's C-Mind test was completely bogus as a measure of intellectual functioning. *See* OB40.

**D. The Exclusion Of This Evidence Was Highly Prejudicial.**

As we have shown (*see* OB39-44), the excluded data and reports contained compelling and consistent evidence, from a variety of sources and doctors, that Merrick was *not* totally disabled and may have been intentionally faking his alleged disability.<sup>12</sup> The excluded evidence also would have shown that doctors and medical consultants with no affiliation to defendants had independently arrived at the same result as defendants, thus impeaching Prater's opinion that defendants' assessment of Merrick's claim was far outside of industry norms. *See* OB44-45. Finally, the post-litigation claim file was critical to demonstrate defendants' good faith and show that they complied with the duty to re-evaluate Merrick's claim in light of new evidence. *See* OB45-46. Merrick does not deny any of this prejudice.<sup>13</sup>

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<sup>12</sup> Attempting to impugn defendants' expert witness, Merrick claims that Dr. Rosenberg "conceded" that he "started out with a particular opinion that the evidence scientifically supports malingering" and then tried to find evidence to justify that conclusion. AB17-18. But the record clearly indicates that Dr. Rosenberg was describing his trial testimony: He started out by giving his "expert opinion" and then gave "the reasons in support of it from a scientific basis." 12/10 182-83.

<sup>13</sup> Merrick's only response is that defendants "overstate" these documents because Dr. Cusher said that it is hard to get an accurate picture of Merrick's functional abilities. AB48. Merrick fails to note that this was because he had been diagnosed as a malingerer by several doctors. *See* ER464.

Instead, Merrick simply notes that defendants made other arguments and claims that “many of the documents in the post-litigation claim file” were separately admitted, thus implying that the excluded information was unnecessary. AB46-48. But as already noted, the fact that defendants had other criticisms of Dr. Sandman does not make the normative data on his C-Mind test irrelevant or cumulative. Moreover, the key documents—Drs. Cusher’s and Kaplan’s reports and medical data from Drs. Etkoff, Athelston, and Novom—were not replicated by the documents that were admitted. Accordingly, the admission of the few documents referenced by Merrick did not undo the prejudice.<sup>14</sup>

### **III. THE DISTRICT COURT’S REFUSAL TO GIVE DEFENDANTS’ PROPOSED INSTRUCTION ON HARM TO NON-PARTIES WAS REVERSIBLE ERROR.**

#### **A. Defendants Preserved This Issue.**

Contrary to Merrick’s assertion (AB48-49), defendants adequately stated the basis of their argument for the proposed instruction by expressly objecting to the district court’s refusal to give the instruction and explaining that “there should be

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<sup>14</sup> Merrick also contends that defendants could have called the authors of the excluded reports as witnesses. AB47-48. But calling Drs. Cusher and Kaplan would have been pointless because, just like defendants’ trial expert, they would have been precluded from testifying about their post-litigation reports and, thereby, from refuting Merrick’s contention that defendants breached their duty of good faith by not reconsidering the claim once litigation had commenced. With respect to Drs. Etkoff, Athelston, and Novom, defendants would have had to pay them to testify, which would have undermined the neutrality of their original reports in the eyes of the jury.

some limiting ... instructions relative to the Campbell decision in terms of what the jury can look at and not look at” (ER806).<sup>15</sup> Cf. *Fireman’s Fund Ins. Co. v. Alaskan Pride P’ship*, 106 F.3d 1465, 1470 n.4 (9th Cir. 1997) (even “[a] generalized objection suffices when the specific objections are framed by a proposed instruction”).

The district court was very familiar with defendants’ position that *State Farm* precludes an award of punitive damages based on harm to others (*see* FER9-10) and clearly understood defendants’ argument for this instruction (*see* ER501, 806-07, 813). Indeed, even when a party does not make a formal objection—as defendants did here (ER806-07)—this Court has held that, “through pretrial briefs, motions for directed verdict, and examination of witnesses, a party can make the district court fully aware of the party’s position in regard to the requested instructions,” thus preserving for review the district court’s failure to give a proposed instruction.<sup>16</sup> *Glover v. Bic Corp.*, 6 F.3d 1318, 1326-27 (9th Cir. 1993) (internal quotation and alteration marks omitted).

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<sup>15</sup> See also ER807 (stating defendants’ objection “to the punitive damages [instructions] without those additional instructions clarifying what Campbell means”); ER501 (citing *State Farm* as authority supporting the instruction).

<sup>16</sup> Merrick relies on *Voohries-Larson v. Cessna Aircraft Co.*, 241 F.3d 707, 714 (9th Cir. 2001), in which the defendant’s objection at trial “related only to the sufficiency of the evidence” and thus did not preserve an unrelated statutory argument for appeal. *Voohries-Larson* is inapposite here because defendants’ argument on appeal simply expands upon their argument at trial.

**B. Failing To Give The Instruction Was Error.**

The Supreme Court has recently granted certiorari in a case that will resolve this issue. *See Philip Morris USA v. Williams*, No. 05-1256, *cert. granted*, 126 S. Ct. 2329 (2006), so we will refrain from rearguing the merits here.

Merrick implies that the instructions actually given were adequate (AB51-52) because the jury was told that it must find oppression, fraud, or malice “in the conduct upon which you base your finding of liability” (CR287:22) and that liability had to be based on the “handling [of] Mr. Merrick’s claim” (CR287:17). But these instructions, at most, told the jury that punitive liability must be based on the conduct that harmed Merrick. They did not go the necessary next step and direct the jury that, having found punitive liability, it could not award punitive damages as punishment for harms to anyone other than Merrick.

Finally, as Merrick notes (AB51), defendants’ proposed instruction did not affirmatively tell the jury the uses to which it could put evidence of harms to non-parties. Contrary to Merrick’s implication, the purely prohibitory nature of the instruction cannot justify its rejection. Defendants’ instruction contained only a limited restriction—“[y]ou may not punish Defendants for conduct or practices that did not affect Plaintiff” (ER501)—which left the jury free to rely on the “bad

company” evidence for other purposes.<sup>17</sup> This type of “prohibitory” limiting instruction is perfectly appropriate. *See, e.g., Borunda v. Richmond*, 885 F.2d 1384, 1388 (9th Cir. 1988) (“Rule 105 obligates the trial judge to restrict the evidence to its proper scope and entitles the opponent to an instruction cautioning the jury to the possibility of forbidden use and admonishing them not to use it for that purpose”); *see generally* 21A Wright & Graham, FEDERAL PRACTICE AND PROCEDURE: EVIDENCE § 5066 (2006) (discussing “prohibitory” instructions).

Moreover, had the district court expressed an inclination to give defendants’ instruction, Merrick could have proposed additional instructions on the valid uses of such evidence. Although the court had discretion to add an “affirmative” element to its “prohibitory” instruction, it was reversible error to refuse to give a limiting instruction once defendants requested one. *See* FRE 105 (“When evidence which is admissible ... for one purpose but not admissible ... for another purpose is admitted, the court, upon request, *shall restrict* the evidence to its proper scope and instruct the jury accordingly.”) (emphasis added).

#### **IV. THE PUNITIVE AWARD IS GROSSLY EXCESSIVE.**

Plaintiff mistakenly contends that, when reviewing the punitive award for

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<sup>17</sup> Contrary to Merrick’s belief, the jury was not entitled to consider the full range of bad-company evidence in assessing the degree of reprehensibility of defendants’ conduct. Under *State Farm*, such evidence may be considered only if “the conduct in question replicates the prior transactions.” 538 U.S. at 423. *See also Williams v. ConAgra Poultry Co.*, 378 F.3d 790, 797 (8th Cir. 2004) (“the relevant behavior must be defined at a low level of generality”).

excessiveness, the Court must place a heavy thumb on the scale by “view[ing] the evidence in the light most favorable” to him (AB54 (emphasis omitted)) and treating its duty to review the evidence *de novo* as “meaningless” (AB59). On the contrary, the Supreme Court has indicated that appellate courts should defer only to a jury’s “specific findings of fact.” *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 439 n.12 (2001); *see also Simon v. San Paolo U.S. Holding Co.*, 113 P.3d 63, 70, 72 (Cal. 2005) (when the jury has made “no ... express finding” on an issue bearing on the *BMW* guideposts, “to infer one from the size of the award would be inconsistent with *de novo* review, for the award’s size would thereby indirectly justify itself”). Here, the jury made no specific findings beyond the basic liability verdict, and thus there are no “specific findings of fact” to which the Court can defer. Moreover, this Court has appropriately held that “a hands-off appellate deference to juries, typical of other kinds of cases and issues, is unconstitutional for punitive damages awards.”<sup>18</sup> *In re*

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<sup>18</sup> Contrary to Merrick’s implication, *Zhang v. American Gem Seafoods, Inc.*, 339 F.3d 1020, 1043 n.14 (9th Cir. 2003), deferred to an explicit jury finding. And in *Leatherman Tool Group, Inc. v. Cooper Industries, Inc.*, 285 F.3d 1146, 1151 (9th Cir. 2002), this Court concluded “[a]fter independent review” that the defendant’s “conduct was more foolish than reprehensible,” thus undermining the factual basis for the jury’s award. Finally, although a panel of this Court appears to have deferred to phantom factual findings in *Hangarter v. Provident Life & Accident Insurance Co.*, 373 F.3d 998, 1014 (9th Cir. 2004), it does not appear to have considered either *Cooper Industries’* limitation of deference to “specific findings of fact” or the renewed call for “exacting” review in *State Farm*. Its failure to review the evidence independently thus does not constitute a binding

*Exxon Valdez*, 270 F.3d 1215, 1238-39 (9th Cir. 2001).

When conducting its excessiveness analysis, this Court does “defer to the district court’s findings of fact unless they are clearly erroneous.” *Planned Parenthood Inc. v. Am. Coalition of Life Activists*, 422 F.3d 949, 954 (9th Cir. 2005). Here, the district court found that, in light of all the evidence at trial, the verdict “very easily could have gone for the defendant.” ER879-80.

Given that finding and a *de novo* review of the evidence, if the Court determines that it cannot give defendants relief under the new-trial standard, then an appropriate response would be to reduce the punitive award to a nominal sum. *Cf. AMPAT/Midwest, Inc. v. Ill. Tool Works Inc.*, 896 F.2d 1035, 1044 (7th Cir. 1990) (when there is “doubt about justification” for a punitive award, but other relief is unavailable, “a sensible response is to cut down the sanction”).

**A. Defendants’ Conduct Was Nowhere Near Sufficiently Egregious To Warrant A \$10,000,000 Punitive Award.**

Although, as Merrick notes (AB55), the jury was required to find that defendants acted with “oppression, fraud, or malice” in order to award punitive damages, the fact “[t]hat conduct is sufficiently reprehensible to give rise to tort liability, and even a modest award of exemplary damages does not establish the high degree of culpability that warrants a substantial punitive damages award.”

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holding and, indeed, could not because it contradicts a prior panel of the Court. *See Exxon Valdez*, 270 F.3d at 1238-39.

*BMW*, 517 U.S. at 580. Merrick’s contention that all five aggravating factors are present here (AB55) is transparently strained, especially in view of the district court’s observation that the underlying verdict “very easily could have gone for the defendant” (ER879-80).

***Physical injury.*** If there were any merit to Merrick’s argument that harm to “peace of mind” can amount to a physical injury (AB56-57), the Supreme Court surely would have said so in *State Farm*, where the elderly insureds were threatened with the imminent loss of their home and life savings. Yet the Supreme Court concluded that “[t]he harm arose from a transaction in the economic realm, not from some physical assault or trauma; there were no physical injuries.” *See* 538 U.S. at 426. To be sure, on remand the Utah Supreme Court did equate harm to peace of mind with physical injury, but that result-oriented holding of an unabashedly defiant state court is not binding here.

In any event, even if denial of an insurance claim ***could*** implicate this factor, Merrick has not made any effort to show that ***he*** suffered the type of emotional devastation that is “closely akin to physical assault or trauma.” *See* AB56-57.

***Reckless disregard for health.*** Although Merrick claims that “all five factors are present to varying degrees” (AB55), he does not even try to identify evidence that defendants ignored a risk to his health.

***Financial vulnerability.*** At trial, it was undisputed that Merrick was

receiving millions of dollars in continuing payments from his partnership (ER747-48), had recently purchased a new million-dollar-plus home in Nevada (12/2 87-88) and, after moving to Nevada, had continued traveling around the country with his mistress and paying her tens-of-thousands of dollars (ER553-72). He was not financially vulnerable. Moreover, Merrick does not even attempt to argue that defendants targeted him because he was financially vulnerable, which is the relevant question (*see* OB53).

***Repeated misconduct.*** Contrary to Merrick’s implication (AB58-59), Prater’s “bad company” testimony did not bear an “*extremely close*” nexus to the handling of Merrick’s claim. As noted above (at pages 7-8), among the litany of alleged bad practices described by Prater, the only ones that he said applied in this case were the “scrub concept” and reliance on objective evidence. There is no evidence of the former, and the latter is perfectly legal. *See* page 8, *supra*.

***Malice, trickery, or deceit.*** Presumably, Merrick’s footnote cross-reference (AB56 n.11) is intended to invoke his allegations that defendants gave him a “trick” monthly-benefit check and tried to “deceive” him into believing that they could deny his claim based on the objective evidence. Under the exacting *de novo* review required here, these contentions should be rejected out of hand. *See* pages 4-6, *supra*.

Finally, Merrick does not dispute that defendants demonstrated substantial

good faith by repeatedly paying him benefits while they considered each new round of evidence that he submitted. And, as noted above (at pages 1-2), Merrick has failed to rebut any of the myriad pieces of objective evidence showing that he was *not* totally disabled, and thus has left unchallenged the reasonableness of defendants' decision.

**B. The 6:1 Ratio Is Indicative Of Excessiveness.**

**1. The highest constitutionally permissible ratio is 1:1.**

Since defendants' opening brief, at least one more court has followed the Supreme Court's edict that "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages" is the constitutional maximum (*State Farm*, 538 U.S. at 425). See *Kent v. United of Omaha Life Ins. Co.*, 430 F. Supp. 2d 946, 957-60 (D.S.D. 2006). In *Kent*, as here, the plaintiff prevailed on a claim of insurance bad faith. Although the \$7,200,000 punitive award was only three times the \$2,400,000 compensatory award, the court nonetheless reduced the punitive damages to a 1:1 ratio under *State Farm*. That result, along with the other cases we have discussed (OB58-61), confirms that the highest constitutionally permissible ratio in this case is 1:1.

The cases that Merrick cites (AB64-65) do not support a ratio higher than 1:1. In *Eden Electric, Ltd. v. Amana*, 370 F.3d 824 (8th Cir. 2004), the court upheld a 4.5:1 ratio only because it agreed with the district court that: "the court

can hardly think of a more reprehensible case of business fraud”; the defendant’s “actions were purposefully designed to maliciously victimize another corporation”; and the defendant’s “agents expressed the desire to ‘f \* \* \* ’ and ‘kill’ [the plaintiff] after taking its \$2.4 million.” *Id.* at 829. And *Zhang*, in which this Court approved a 7:1 ratio, involved compensatory damages of only \$360,000 and conduct—racial and ethnic discrimination—that this Court deemed to be significantly more reprehensible than the bad-faith conduct in *State Farm*. 339 F.3d at 1043; *see also S. Union Co. v. Sw. Gas Corp.*, 415 F.3d 1001, 1011 (9th Cir. 2005) (holding that “civil rights case ratios,” such as *Zhang*, do not apply to “a private tort action”). In *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 345 F.3d 1366 (Fed. Cir. 2003), the court concluded that the defendant’s fraudulent conduct was “egregious” and then, after a perfunctory analysis, upheld a 3.33:1 ratio based on the erroneous conclusion that any ratio below 4:1 is presumptively constitutional. *Id.* at 1372.

The other cases that Merrick cites involved both smaller compensatory awards and greater reprehensibility. *See McClain v. Metabolife Int’l, Inc.*, 259 F. Supp. 2d 1225, 1232, 1237 (N.D. Ala. 2003) (\$50,000 compensatory damages and conduct that “deliberately ... subject[ed] the consuming public to the risk of suffering a stroke”), *rev’d on other grounds*, 401 F.3d 1233 (11th Cir. 2005); *Trinity Evangelical Lutheran Church v. Tower Ins. Co.*, 661 N.W.2d 789, 802

(Wis. 2003) (\$500,000 actual and potential harm; conduct was “continuing, egregious, and flagrant”); *Bocci v. Key Pharms., Inc.*, 76 P.3d 669, 675 (Or. Ct. App. 2003) (\$500,000 compensatory damages and “deceitful conduct involving the promotion of a prescription drug as ‘safe’ when it was not, which resulted in ... severe physical injury”).

Finally, Merrick’s suggestion that this Court should reject a 1:1 ratio here because a ratio of 2.6:1 was held to be constitutional in another case involving these and other defendants (AB64) ignores the many factual disparities between this case and *Hangarter* (*see* OB61 n.22).<sup>19</sup>

## **2. The Court should use one ratio.**

Merrick’s attempt to circumvent *State Farm* and *BMW* by using the same compensatory damages as the denominator in two separate ratio calculations (AB61-62) is misguided. When this Court calculated the maximum constitutionally permissible punitive award in *Planned Parenthood*, it multiplied the joint-and-several compensatory award by the highest-permissible ratio and then “allocate[d] that amount of punitive damages among defendants in the same proportion as the jury did in its verdicts” (thus preserving the jury’s assessments of varying reprehensibility). 422 F.3d at 963. True, the panel considered a host of

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<sup>19</sup> In another case involving UnumProvident, the District of Arizona recently determined that the highest constitutionally permissible ratio was 1.5:1, expressly distinguishing *Hangarter*. *See Leavey v. Unum/Provident Corp.*, 2006 WL 1515999, at \*15 (D. Ariz. May 26, 2006).

other calculations before reaching this result and first stated that it had rejected this approach (*id.* at 960) and adopted another (*id.* at 962). However, those intermediate steps were irrelevant to the ultimate holding. Indeed, Merrick’s preferred method would have resulted in plaintiff Crist receiving a total punitive award of \$4,996,656—\$39,656 x 9 (the ratio) x 14 (the number of defendants)—rather than \$356,904 (*id.* at 964).<sup>20</sup> When it came time to calculate the highest award that the Constitution permitted in *Planned Parenthood*, this Court used the method we have advocated here.

If the Court is inclined to treat the punitive awards independently, however, “the more appropriate way of calculating the ratios is to divide the individual punitive damages awards by the individual [defendants’] shares of the actual damages.” *Grabinski v. Blue Springs Ford Sales, Inc.*, 203 F.3d 1024, 1026 (8th Cir. 2000). Here, it would make most sense to assign the contract damages to Paul Revere (the only defendant in privity with Merrick) and divide the tort damages equally between the defendants. That would result in a ratio of 32:1 for

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<sup>20</sup> In other words, adopting Merrick’s individual-defendant methodology and using Merrick’s example (AB61), this Court necessarily concluded that the highest ratios permitted by the Constitution in *Planned Parenthood* were 0.31:1 (\$12,307/\$39,656) for Stover and 0.62:1 (\$24,614/\$39,656) for Wysong. 422 F.3d at 963-64. If those are the highest permissible ratios when the compensatory damages are only \$39,656 and the conduct involves threatening to kill someone, destroying relationships and careers, and causing severe psychological trauma, only much lower ratios are permissible here.

UnumProvident (\$8,000,000/\$250,000) and 1.43:1 for Paul Revere (\$2,000,000/\$1,397,355).

**3. The ratio should not include potential harm or attorneys' fees and should be reduced in light of the emotional distress award.**

To be considered in the analysis, potential harm must be "likely." *Pulla v. Amoco Oil Co.*, 72 F.3d 648, 659-60 (8th Cir. 1995) (retired Justice Byron White, sitting by designation); *see also Cooper Indus.*, 532 U.S. at 442 (rejecting plaintiff's measure of potential harm as "unrealistic"). Merrick's measure of future harm is unlikely and unrealistic for two reasons.

First, as defendants' repeated reconsideration of Merrick's claim demonstrates, the denial of a claim does not preclude future payment of benefits upon the submission of further evidence. Second, insureds often improve and are able to return to work, thus ending the payment of benefits. Indeed, Dr. Cheney, Merrick's CFS expert, said that the majority of individuals with CFS return to work within a few years. ER166. Thus, Merrick's suggested potential harm, his benefits for life (AB62-63), is purely speculative. At the very least, Merrick's proposed amount must be reduced to present value.

Merrick's suggestion that his attorneys' fees should be included in the denominator (AB63) also is mistaken. The single state case he cites, *Hollock v. Erie Insurance Exchange*, 842 A.2d 409, 421-22 (Pa. Super. Ct. 2004), involved a

statutory regime in which attorneys' fees are part of the compensatory damages. *See Willow Inn, Inc. v. Pub. Serv. Mut. Ins. Co.*, 399 F.3d 224, 236-37 (3d Cir. 2005). The more appropriate authorities are those cited in our opening brief (at 62-63) indicating that an award of attorneys' fees mitigates the need for punitive damages.

Finally, Merrick contends that defendants should not be "punished *less* because they *also* caused [him] to suffer emotional injuries." AB66. But he does not deny that emotional-distress damages already have a punitive component (*see* OB62). Our argument (*id.*) is only that the Court should take this punitive aspect of Merrick's compensatory award into account when comparing his "punitive" and "compensatory" damages.

### **C. The Punitive Damages Are Grossly Disproportionate To The Legislatively-Established Penalty For Comparable Conduct.**

Merrick contends that this guidepost supports the punitive award because Nevada could have revoked defendants' licenses. AB66-67. But he has not cited a single instance in which Nevada, or any other state, has revoked an insurer's license for any reason, let alone for the denial of a claim.<sup>21</sup>

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<sup>21</sup> Under this guidepost, the punitive award is compared to the legislatively-established penalties that actually would be expected for similar conduct, not the highest penalty possible under the law. *See Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320, 1337 (11th Cir. 1999). Thus, the Seventh Circuit's reliance on the possible revocation of a hotel license for chronic bed bug infestations—*see*

Trying to escape the fact that this *precise* argument was made and rejected in *State Farm* (see 538 U.S. at 428), Merrick contends that here, unlike *State Farm*, Prater’s “bad company” testimony bore a nexus to the handling of the claim (AB66-67). As noted above (at pages 7-8), however, most of Prater’s alleged “bad company” practices (e.g., “top ten lists” and “roundtables”) had nothing to do with Merrick’s claim.

Regardless, the jury’s explicit finding that Paul Revere did *not* violate N.R.S. § 686A.183 (FER14) definitively establishes that Paul Revere could not be fined, let alone have its license revoked, for its handling of Merrick’s claim. ER862-63. Merrick has not challenged that portion of the verdict. Because the punitive award is *2000 times* the maximum civil penalty for violations of a statute that defendants did *not* violate, the award is obviously grossly excessive.

**D. Merrick’s Argument That A High Punitive Award Is Necessary To Deter Continuing Practices Lacks Merit.**

Merrick argues that defendants should be more severely punished because they “have shown no indication that they intend to change their practices.” AB68. On the contrary, it is public knowledge, of which Merrick’s counsel is aware and this Court can take judicial notice, that, after a thorough 50-state review of their practices, defendants have entered into comprehensive settlement agreements with

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*Mathias v. Accor Econ. Lodging, Inc.*, 347 F.3d 672, 678 (7th Cir. 2003) (cited at AB66-67)—is inapposite here.

almost every state’s insurance regulator, pursuant to which defendants have revised various claim-handling practices and agreed to heightened oversight by state regulators. See Multistate Exam Settlement Agreements, available at <http://www.unumprovident.com/settlementagreement>; California Settlement Agreement, available at <http://www.insurance.ca.gov/0400-news/0100-press-releases/0080-2005/upload/CSA.pdf>. See also UnumProvident Response to California Settlement Agreement, <http://www.insurance.ca.gov/0400-news/0100-press-releases/0080-2005/upload/response.pdf>. Thus, Merrick’s suggestion that a high punitive award is required to deter continuing practices is simply false.

#### **V. THE AWARD OF ATTORNEYS’ FEES SHOULD BE VACATED.**

Directly contrary to Merrick’s unsupported assertion that Nevada “vests the district court with broad discretion to award attorney’s fees” (AB69), Nevada has, in fact, “severely restricted the discretion of the court in granting attorneys’ fees.” *Swallow Ranches, Inc. v. Bidart*, 525 F.2d 995, 999 (9th Cir. 1975).

Abandoning the rationale for attorneys’ fees that he advanced at trial (*see* OB65-66; ER871-80), Merrick now appears to concede—as he must—that *Farmers Home Mutual Insurance Co. v. Fiscus*, 725 P.2d 234 (Nev. 1986), does *not* require an award of attorneys’ fees in every bad-faith case.<sup>22</sup> Instead, as

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<sup>22</sup> Merrick does not deny that *Fiscus* could *not* create a new rule requiring attorneys’ fees in all bad-faith cases because, under Nevada law, courts are not

Merrick admits, the relevant question is whether, in *this* case, “[a]s in *Fiscus*, the finding of bad faith against Defendants ‘was at least tantamount to finding that [their] defense was maintained without reasonable ground.’” AB70. But the district court already has decided that question, correctly, against Merrick. *See* ER871-80.

Merrick ignores the court’s conclusion and instead claims that the *jury’s* bad-faith verdict proves that defendants’ case was frivolous. AB70. But the jury decided only that Merrick’s claim was supported by a preponderance of the evidence, not that defendants’ defense was “not supported by any credible evidence at trial” (*Barozzi v. Benna*, 918 P.2d 301, 303 (Nev. 1996)).<sup>23</sup> That is why the decision to award attorneys’ fees is vested in the court, not the jury. *See* N.R.S. 18.010(2)(b). Here, after explicitly deciding that attorneys’ fees are not warranted on the facts, the district court mistakenly awarded them based on a misinterpretation of *Fiscus*. ER871-80. This Court should now correct that error.

## CONCLUSION

We renew defendants’ original request for relief (OB68) except that, with respect to our first question presented, we request a new trial rather than JMOL.

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authorized to expand or alter the rules for awarding attorneys’ fees. *See First Interstate Bank v. Green*, 694 P.2d 496, 498 (Nev. 1986).

<sup>23</sup> For the same reason, Merrick’s citation of *Albert H. Wohlers & Co. v. Bartgis*, 969 P.2d 949 (Nev. 1999) (AB70)—which deals with bad-faith verdicts, not attorneys’ fees—is off point.

Respectfully submitted.

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**CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(B)**

Case Nos. 05-16380 and 05-17059

I certify that:

**Oversize Briefs:**

The court granted permission to exceed the length limitations set forth at Fed. R. App. P. 32(a)(7) by an order dated October 26, 2006.

The brief is

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contains no more than 7,746 words

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Carl J. Summers

## **CERTIFICATE OF SERVICE**

I hereby certify that on this 1st day of November, 2006, I served a total of six copies of the foregoing Reply Brief for Appellants by overnight delivery on Appellee herein, two to each of the following addresses:

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