

Nos. 05-16380 and 05-17059

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

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.

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

BRIEF FOR THE APPELLANTS

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Defendant The Paul Revere Life Insurance Company is a subsidiary of The Paul Revere Corporation, which is a wholly-owned subsidiary of defendant UnumProvident Corporation, which is a publicly-held corporation. No other publicly-held corporation owns 10% or more of UnumProvident Corporation's stock.

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JURISDICTIONAL STATEMENT

The district court had jurisdiction under 28 U.S.C. § 1332. It entered final judgment on January 12, 2005, and entered an order denying defendants' post-trial motions on June 6, 2005. On August 5, 2005, defendants moved for an extension of time in which to file a notice of appeal under FRAP 4(a)(5). The district court granted that motion on September 15, 2005. Defendants filed a timely notice of appeal on September 21, 2005. That appeal (05-17059) was consolidated with an earlier appeal (05-16380) that plaintiff had moved to dismiss as untimely. This Court has jurisdiction under 28 U.S.C. § 1291.

ISSUES PRESENTED

Clinton Merrick filed a disability claim under his own-occupation total-disability insurance policy, stating that he was totally disabled from his occupation as a venture capitalist by virtue of cognitive deficits and fatigue associated with Chronic Fatigue Syndrome ("CFS"). After paying benefits for over a year while investigating Merrick's claim, defendants denied the claim because the testing conducted on Merrick established that he was able to function normally. Merrick brought this lawsuit and received a jury verdict finding that he was totally disabled from his occupation and that defendants denied his claim in bad faith. The jury awarded him \$1,147,355 in past-due benefits, \$500,000 for emotional distress, and

\$10,000,000 in punitive damages. The district court subsequently awarded Merrick \$500,000 in attorneys' fees.

Defendants do not dispute that Merrick adduced evidence from which a reasonable jury could conclude that he was totally disabled, and hence do not seek JMOL on that issue. The issues presented in this appeal are:

1. Whether defendants are entitled to JMOL on the issue of bad faith because the objective evidence of Merrick's functional abilities provided a reasonable basis for concluding that Merrick was not totally disabled.

2. Whether defendants are entitled to JMOL on the issue of punitive damages because, as the district court recognized, the underlying verdict in this case "very easily could have gone for the defendant."

3. Whether the district court erred in excluding: (i) information about Merrick's medical condition that defendants obtained after litigation began and (ii) all evidence of defendants' ongoing claim handling during litigation.

4. Whether the district court erred in refusing to instruct the jury that, in awarding punitive damages, it could not punish defendants for conduct that had no effect on Merrick.

5. Whether the \$10,000,000 punitive damages award is unconstitutionally excessive.

6. Whether Nevada law requires an award of attorneys' fees in every insurance bad-faith case, as the district court held, or only when the defendants' position at trial was not supported by any credible evidence.

STATEMENT OF THE CASE

The relevant procedural history is set forth at page 1, *supra*.

STATEMENT OF FACTS

1. Merrick's Policy

Merrick purchased a disability policy from The Paul Revere Life Insurance Company ("Paul Revere") on December 18, 1989. ER1. Under that policy, if "because of Injury or Sickness," Merrick were "unable to perform the important duties of [his] Occupation" and were "under the regular and personal care of a Physician" (ER2) for at least 180 days, then, starting on the 181st day, he would be entitled to a "total disability" benefit of \$12,000 per month (ER1).

The district court determined that Merrick's policy would be interpreted under Massachusetts law. ER486. Thus, Merrick was not "totally disabled" under the policy if he could work part-time in his occupation. *See, e.g., Doyle v. Paul Revere Life Ins. Co.*, 144 F.3d 181, 186 (1st Cir. 1998) (denial of total-disability benefits is appropriate when insured can work part-time); *August v. Offices Unlimited, Inc.*, 981 F.2d 576, 582 (1st Cir. 1992) (implying that total disability means inability to work either part-time or full-time). He also was not totally

disabled if he could perform some, but not all, of the important duties of his occupation. *See, e.g., Valenti v. Paul Revere Life Ins. Co.*, 2002 WL 406972, at *3 (Mass. Super. Ct. Mar. 13, 2002) (“The plain meaning” of total disability “is that, if [an insured] can perform some of the important duties of her occupation, she is not totally disabled.”).

2. Merrick’s Occupation

In 1984, after a successful career as a business executive, Merrick became one of three partners in a venture capital firm. His “important duties” involved raising capital; researching, negotiating, and recommending to the partnership investments in early-stage companies; approving investments recommended by his partners; and sitting on the boards of directors for companies in which the firm had invested. ER102.

In “the middle of 1992,” Merrick’s two partners told him that they would be forming a new partnership without him. ER839. They dropped Merrick because investments he had made in the 1980s had “seemed very logical and very diligent and very persuasive” at the time, but “kept going south,” causing them to lose faith in Merrick’s judgment as an investor. ER838; *see also* ER823-24, 843-44. One of Merrick’s partners said that he still would have recommended Merrick to *run* a company, but that Merrick was not naturally suited to succeed as an investor. ER841-42. Merrick negotiated a separation agreement, signed on July 2, 1993,

under which he received his full salary and was allowed to remain on the board of directors for some companies until June 30, 1994. ER6-7.

3. Merrick's Claim

On July 28, 1994, Merrick sent a letter to Paul Revere stating that he was “suffering from a disabling condition” but was not yet filing a claim. ER31. At the time, Merrick’s treating physician was Dr. Epstein, a psychiatrist. ER104.

Dr. Frohwirth. Two months before that letter, on May 31, 1994, Dr. Epstein had referred Merrick for psychological testing with Dr. Frohwirth, “the purpose of which was to document [Merrick’s] claim for psychiatric disability.” ER27-30. Merrick scored 108 on an IQ exam administered by Dr. Frohwirth (receiving a verbal score of 116 and a performance score of 96). ER28. His results on an Employee Aptitude Survey were “clearly superior to men in general,” but “modest” compared to other “Top Managers.” *Id.* And his “[m]emory functions [were] similarly adequate,” with scores ranging from 105 to 127 (average to excellent). ER28-29. Dr. Frohwirth also noted that, throughout a three-day “lengthy testing procedure,” Merrick did not become excessively fatigued. ER27.

Although Dr. Frohwirth opined that Merrick “has likely suffered a decrement in mental acuity,” he did not conclude that Merrick was disabled (at all, let alone totally) and admitted that “[t]he question remains whether these findings reflect nothing more ominous than a chronic, compensated learning disability and

Attention-deficit Disorder.” ER30. Finally, Dr. Frohwirth observed that Merrick has a tendency to “magnify the level of experienced illness,” “complain,” and be “self-pitying” (ER27) and that, “because he is looking to document a disability claim, he has a vested, [] even if unconscious, motive to appear disabled” but “appeared to make[] his best effort on all tests” (ER30).¹

The Mayo Clinic. Four months after Dr. Frohwirth’s testing, Merrick had a new treating physician, Dr. Rapaport. ER104. On December 10, 1994, Dr. Rapaport referred Merrick for testing by several doctors with different specialties at the Mayo Clinic. ER40-85.

- Dr. Squires found that Merrick had an “entirely normal” exercise test with “excellent” exercise duration. ER49.
- Mr. Daube tested Merrick’s visual and auditory perception and noted that Merrick had “normal & symmetrical” responses. ER51-52.
- Dr. Maruta, a psychiatrist, said that there was “[n]o evidence of clinical depression on exam.” ER59.
- Dr. Ivnik, a psychologist, reported that Merrick scored 114 on an IQ exam (receiving a verbal score of 119 and a performance score of 108). ER63. Although Dr. Ivnik’s battery of tests showed that Merrick had a

¹ Defendants did not obtain Dr. Frohwirth’s results until September 1996 (*see* ER134-38)—four months before they denied Merrick’s claim—because Merrick did not disclose Dr. Frohwirth on his claim form (ER101).

few areas of mild deficit—such as “mildly impaired” reaction time—and a few areas of modest excellence—such as above-average verbal functioning—Dr. Ivnik concluded that Merrick’s “general cognitive functioning is * * * high average” and that “there isn’t much evidence to suggest that his true intelligence was ever much better than current IQs suggest.” ER67-69. Summarizing his results, Dr. Ivnik said:

This gentleman’s cognitive problems are mild. They may frustrate him but they shouldn’t represent a major disability for him. His worst abilities are ‘low average for age’ and most of his functioning is mid to high-average. He 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 reported the results of a sleep study, which determined that Merrick may have difficulty falling asleep and may wake himself up if he sleeps on his back, which he does only rarely, but that Merrick was not excessively sleepy (hypersomnolescent).

ER77-82.

- Finally, Dr. Silber, who oversaw Merrick’s treatment at the Mayo Clinic, summarized Merrick’s self-reported symptoms and the results of the other examinations (ER71-76, 91-92) and then diagnosed Merrick as having CFS, concluding: “I advised that he

restart work but at a much lower stress level and lower time commitment than before” (ER76, 92).

On February 16, 1995, Merrick submitted a claim form (ER93-103) indicating that he had “Chronic Fatigue Syndrome” and that he was totally disabled by virtue of “significant impairment of intellectual ability” and “fatigue” (ER100). Merrick said that his “[s]ymptoms have been present and progressively worse since 1991” and that he became totally disabled on June 30, 1994. *Id.* Paul Revere began paying the claim—retroactive to December 27, 1994 (the first day after expiration of the policy’s waiting period)—while its internal consultants reviewed Merrick’s file. ER105.

On June 21, 1995, Merrick’s other disability insurer, Northwestern Mutual, told Paul Revere that Merrick “wants to become involved in another business venture—w[ith] less stress involved.” ER106-07. On the assumption that, if Merrick was looking for work in “another business venture,” he must not be totally disabled, Paul Revere arranged a field visit to “discuss [Merrick’s] current limitations and activities” and to offer Merrick a four-month recovery benefit (a conditional settlement of his claim, with the possibility of reopening it at the end of four months) if he “is actively looking for work.” ER116-17. In a meeting on August 2, 1995, the field representative “discussed the return to work and recovery

provision,” but Merrick declined, so the representative gave him a check for his monthly benefit.² ER121.

Dr. Donaldson’s IME. Paul Revere then arranged for Dr. Donaldson, a professor of neurology at the University of Connecticut, to conduct an Independent Medical Examination (“IME”) of Merrick on December 15, 1995. *See* ER125-29. After relaying the history he took from Merrick, Dr. Donaldson reported that Merrick had a “normal neurological examination” and noted that prior neurological testing conducted by Merrick’s own doctors “shows that he intellectually functions in the mid-to-high-average range, probably consistent with his previous capacities.” ER128. Dr. Donaldson concluded that “Merrick does not have * * * an active neurological problem,” but opined that he may need psychiatric treatment because he “is depressed” and is “an over-achiever who has run out of gas.” ER129.

Dr. Rapaport. Paul Revere asked Dr. Rapaport, Merrick’s treating physician, to comment on Dr. Donaldson’s conclusions, specifically on his conclusion that Merrick does not have any neurological (*i.e.*, cognitive) deficits but may be having psychiatric (*i.e.*, emotional) problems. ER130. On May 30, 1996,

² Merrick returned this check because he mistakenly believed that the “release and discharge” provision would effect a settlement of his full claim. ER122. Paul Revere explained that the release and discharge was, on its face, for only “Partial Payment” (*see* ER223) and reassured Merrick that his claim was continuing. ER124.

Dr. Rapaport responded, asserting that Merrick is *not* “significantly depressed” but *does* have an “active neurological problem.” ER132. In other words, according to Dr. Rapaport, Merrick could not perform the important duties of his occupation because he had deficits in his neurological functioning.

As support for Merrick’s alleged neurological problems, Dr. Rapaport cited an abnormal “flash visual evoked potential” (*see* ER32-33) and an abnormal “MRI scan” (*see* ER34-36). ER133. But the doctor who performed the MRI scan said that it simply indicated old head trauma, consistent with Merrick’s report of several childhood head injuries. ER34-36; *accord* ER76, 91, 128. In any case, an MRI does not provide evidence of functional deficiencies, let alone deficiencies of recent onset. *See, e.g.*, ER128 (Dr. Donaldson’s IME report). The abnormal “flash visual evoked potential,” on the other hand, did indicate a mild functional-perceptual deficiency. ER32-33. As Dr. Frohwirth had concluded two years before, however, Merrick demonstrated “*chronic* visual ‘perceptual’ deficits, which would be consistent with [a] learning disability (now compensated) and which would explain his spotty academic record.” ER28 (emphasis added).

In other words, Dr. Rapaport did not identify any evidence that would support Merrick’s claim that, starting in June 1994, he was so cognitively disabled that he could no longer perform the important duties of his occupation. Indeed, although Drs. Epstein and Rapaport both certified that Merrick was totally

disabled, this conclusion was contradicted by the objective results obtained by Drs. Frohwirth, Squires, Daube, Maruta, Ivnik, Silber, and Donaldson—all of which showed Merrick to be functioning normally—and amounted to little more than Drs. Epstein’s and Rapaport’s personal confidence in Merrick’s self-description.³

4. Paul Revere Denies Merrick’s Claim

On September 12, 1996, Paul Revere’s psychological consultant conducted a full review of all evidence that had been submitted by Merrick or gathered by Paul Revere. ER136-38. He concluded, based primarily on the results obtained by Drs. Frohwirth, Ivnik, and Donaldson, that “there does not appear to be any neuropsychologically-based disability.” ER138. Therefore, Paul Revere ordered another field visit to offer Merrick a compromise settlement. As the claim handler explained to the field representative:

We do feel ins[ured] is depressed, and has some minor cognitive problems * * *. However, based on all information rec[ieve]d, we do not find these to be of disabling proportions. * * * If compromise cannot be met, we do feel that objective medical data & reviews provide basis for denial of further benefits.

ER139-40. On November 26, 1996, Merrick refused the offer of settlement. ER141-42.

In a follow-up phone call, a Paul Revere claim handler told Merrick “that based on our review of all med[ical] info[r]mation] his impairments he might be

³ Indeed, Dr. Rapaport later testified that his certification was based primarily, if not exclusively, on the history given by Merrick. ER849.

having would not be of TD [total disability] proportions.” ER144. However, Paul Revere agreed to continue paying the claim for another month while Merrick submitted new medical information. ER145-47.

The QEEG. The new information that Merrick submitted was a QEEG scan. ER148-50. Paul Revere’s medical consultant concluded that the “QEEG is not recognized as a valid tool for evaluating cognitive impairment.”⁴ ER151-52 (emphasis in original).

On January 6, 1997, Paul Revere told Merrick that his claim had been denied. ER153.

5. Merrick’s Claim Remains Closed

During two subsequent phone calls with Merrick, on January 28 and 30, 1997, Paul Revere again explained its conclusion that the evidence did not support his assertion that he was totally disabled. ER154-57. Paul Revere told Merrick that, at this point, it would not reopen the claim unless there was some objective evidence to support his subjective account of his impairments (and to counteract the existing objective evidence showing that Merrick was functioning normally).

Id. Once again, however, Paul Revere agreed to pay Merrick one month’s benefits while he submitted new medical information. ER158.

⁴ At trial, the judge characterized the QEEG as “witch doctoring” and excluded it from evidence. ER526-27.

Dr. Cheney. On June 11, 1997, Merrick submitted a report by Dr. Cheney, a self-proclaimed expert in CFS. ER159-67. After diagnosing Merrick with CFS, Dr. Cheney relied on three tests as evidence of Merrick’s functional abilities (ER162-66):

- First, Dr. Cheney cited the already-discredited QEEG scan. ER164-66.
- Second, Dr. Cheney cited Merrick’s results on a “Bicycle Exercise Ergometry” test. ER162-66. That test, like the QEEG, was excluded by the district court as junk science. ER527-33.⁵
- Third, Dr. Cheney cited Merrick’s results on the “C-Mind,” or “Irvine Memory Battery,” test. ER164-66. Although defendants’ medical consultants did not explicitly discuss this testing in their comments on Dr. Cheney’s results (*see* ER176-78), defendants’ psychological expert testified at trial that the “C-Mind” test “has no scientific validation,” is “not accepted in the [scientific] community,” and “is considered to be of no significance” (ER805).

Finally, without any apparent support in the record—and contrary to prior psychological and physical testing showing Merrick’s above-average abilities—Dr.

⁵ Moreover, as defendants discovered after requesting Dr. Cheney’s full records, Merrick actually performed normally (by Dr. Cheney’s standards) the first two times he took this test. ER168-75. It was only when multiple tests were administered within 24 hours, contrary to Dr. Cheney’s own protocols, that Merrick received what Dr. Cheney considered to be abnormal results. ER172-75; *see also* ER801-03.

Cheney opined that Merrick was “unable to work in any capacity * * * in any type of gainful employment, even the most part-time, sedentary job” and that Merrick “cannot be expected to perform any task, physical or cognitive, for any significant period of time, and certainly not in a repetitive manner.” ER166.

On July 21, 1997, Defendants’ medical consultant concluded that Dr. Cheney’s results did not provide any valid evidence that Merrick was totally disabled.⁶ ER176-78.

Dr. Sandman. On December 5, 1998, Dr. Cheney referred Merrick for psychological testing by Dr. Sandman. ER304-31. Dr. Sandman noted that the “Barona Estimate” placed Merrick’s “pre-morbid” IQ (*i.e.*, his “normal” IQ before his alleged disability) at 114, although Dr. Sandman speculated that it was probably higher. ER308-09. Testing performed by Dr. Sandman showed that Merrick’s current IQ was 118 (with a verbal score of 128 and a performance score of 104). ER314. Dr. Sandman concluded that “Mr. Merrick is functioning in the High Average Range of Intelligence.” ER327. Merrick received normal or above-average results on the Wisconsin Card Sort Test, the Trail-Making Test, and the Boston Naming Test. *Id.* On the Wechsler Memory Scale, Merrick scored “within the Average Range on seven of the eight [scales] and Above Average on one,”

⁶ We refer to “defendants” from this point forward because Paul Revere was acquired by Provident Companies, Inc. (n/k/a UnumProvident) in March 1997. *See* ER615-17.

although he performed poorly on a few subtests and excellently on others. ER317-18. Dr. Sandman also administered the “Irvine Memory Battery,” or “C-Mind” test, and reported deficient performance on some of the sub-tests. ER321-27.

Defendants’ psychological consultant reviewed Dr. Sandman’s report and observed that, “[f]or the most part, the results of the more traditional neuropsychological tests [performed by Dr. Sandman] are similar to those obtained by Drs. Frohwirth and [Ivnik]; and fall within normal limits (average or better scores).” ER395. He noted, however, that, “[i]n contrast to [Merrick’s] globally intact performance on traditionally used neuropsychological tests, his performance on the C-Mind tests was listed as more variable and as being suggestive of impairment.” ER396. The consultant was “unable to fully evaluate the meaning of this discrepancy [in the test results]” because he could not find any literature or normative data on the “C-Mind” test. *Id.* Defendants first requested the normative data from Dr. Sandman and Merrick’s attorney in November 1999. *See* ER398-99. But Dr. Sandman did not produce the information until after Merrick filed suit, in April 2000, and defendants issued a subpoena.⁷ *See* ER455. As noted above, however, defendants’ expert testified that this test “has no scientific validation,” is

⁷ Because the district court excluded the evidence of defendants’ post-litigation claim handling (*see* Part II, *infra*), the jury was not allowed to see either the normative data or the resulting conclusion of defendants’ consultant that the “C-Mind” test was invalid and that Dr. Sandman’s results do not demonstrate total disability.

“not accepted in the [scientific] community,” and “is considered to be of no significance.” ER805.

SUMMARY OF THE ARGUMENT

Merrick’s claim presented defendants with a dilemma. On the one hand, defendants had consistent objective testing, much of it performed by Merrick’s own physicians, showing that Merrick was functioning normally. On the other hand, Merrick was claiming that he had severely debilitating cognitive impairments and fatigue. Defendants concluded that the consistent empirical evidence presented a more accurate picture of Merrick’s true functional abilities—a conclusion that was reinforced by each new piece of clinically valid evidence that defendants received.

Defendants recognize that, on the question whether Merrick really was totally disabled, the jury could have chosen to believe Merrick’s personal account of his condition, which is sufficient to justify the jury’s verdict on the insurance contract. But that is as far as the evidence will take Merrick.

Even if defendants’ claim decision was wrong, it was supported by compelling medical evidence, much of which was provided by Merrick’s own physicians. Indeed, during the hearing on the post-trial motions, the district court acknowledged that “the jury could have gone either way on this” (ER871) and “very easily could have gone for the defendant[s]” (ER880). That observation

should have led directly to JMOL on bad faith and punitive damages. When, as here, an insurer has a reasonable basis for denying a claim, there is no bad faith as a matter of law. *See* Part I.A. And even if making a claim decision based on objective evidence somehow amounted to bad faith, it certainly would not be the type of reprehensible act that justifies an award of punitive damages. *See* Part I.B.

Moreover, although the evidence at trial was sufficient to support the jury's finding of total disability, defendants are entitled to a new trial on that issue because the district court erroneously excluded highly probative evidence on the patently mistaken assumption that defendants had withheld documents during discovery. The record provides no reason to think that defendants had withheld documents, and defendants' counsel affirmed under penalty of perjury that they had disclosed everything. Nevertheless, as a sanction for this fictitious violation, the district court excluded almost all of the evidence relating to defendants' post-litigation claim handling, including: (i) claim-handling documents proving that defendants complied with their ongoing duty to consider new evidence received after litigation begins, and (ii) important new medical records from several doctors that supported defendants' conclusion that Merrick was functioning normally. Because the verdict in this case "very easily could have gone for the defendant[s]" (ER880), the erroneous exclusion of this evidence requires a new trial on all issues. *See* Part II.

Failing that, defendants are entitled to a new trial on punitive damages because the district court refused to properly instruct the jury that it could punish defendants only for conduct that harmed Merrick. Due process requires such an instruction when, as here, the plaintiff has introduced evidence of broad corporate practices. *See* Part III.

At minimum, the punitive award must be substantially reduced because it is unconstitutionally excessive. Defendants' conduct was not sufficiently reprehensible to support an award six times the substantial compensatory damages (which already include a large punitive element) and 2,000 times the maximum legislatively established punishment in Nevada. The highest constitutionally permissible punitive award in this case is the amount Merrick received for economic damages. *See* Part IV.

Finally, the award of attorneys' fees should be vacated. The district court conceded that it would not have awarded attorneys fees if left to its own devices. It concluded, however, that a particular Nevada case created a new rule that attorneys' fees must be awarded in all bad-faith cases. The district court not only misinterpreted that case, but fundamentally misunderstood Nevada law, which does not authorize courts to create new rules for awarding attorneys' fees. *See* Part V.

STANDARDS OF REVIEW

This Court reviews the denial of a Rule 50(b) motion *de novo*, taking the evidence in the light most favorable to the non-moving party. *White v. Ford Motor Co.*, 312 F.3d 998, 1010 (9th Cir. 2002), *amended by* 335 F.3d 833 (9th Cir. 2003). The Court reviews a district court's evidentiary rulings for abuse of discretion, and will reverse if such errors more likely than not affected the verdict. *Id.* at 1006. It reviews a district court's refusal to give a jury instruction for abuse of discretion. *Id.* at 1012. The district court's conclusion that the \$10,000,000 punitive award is not unconstitutionally excessive is reviewed *de novo*. *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001). Finally, this Court reviews "the district court's interpretation and application of a state statute governing the award of attorney's fees *de novo*." *Jorgensen v. Cassidy*, 320 F.3d 906, 918 (9th Cir. 2003).

ARGUMENT

- I. **DEFENDANTS ARE ENTITLED TO JMOL ON THE ISSUES OF BAD FAITH AND PUNITIVE DAMAGES.**
 - A. **The Denial Of Merrick's Claim Did Not Constitute Bad Faith Because Defendants Had A Reasonable Basis For Concluding That Merrick Was Not Totally Disabled.**

Although the contract was interpreted according to Massachusetts law, Merrick's bad-faith claim was tried under Nevada law. *See* ER486. According to Nevada law,

[a]n insurer breaches the duty of good faith when it refuses without proper cause to compensate its insured for a loss covered by the policy. An insurer is without proper cause to deny a claim when it has an actual or implied awareness that no reasonable basis exist[s] to deny the claim. Thus, the insurer is *not liable for bad faith* for being incorrect about policy coverage as long as the insurer had a *reasonable basis* to take the position that it did.

Pioneer Chlor Alkali Co. v. Nat'l Union Fire Ins. Co., 863 F. Supp. 1237, 1242 (D. Nev. 1994) (applying Nevada law) (emphasis added) (internal quotation marks and citations omitted); *accord Albert H. Wohlers & Co. v. Bartgis*, 969 P.2d 949, 956 (Nev. 1999) (“Bad faith is established where the insurer acts unreasonably and with knowledge that there is no reasonable basis for its conduct.”). In other words, there is room in the law for an insurer to be wrong about coverage without acting in bad faith.

Because the record conclusively demonstrates that defendants had a reasonable basis for denying Merrick’s claim—even if that decision was ultimately judged to be incorrect—defendants are entitled to JMOL on the bad-faith claim.

1. Defendants had a reasonable basis for denying Merrick’s claim.

At the time defendants denied Merrick’s claim, the evidence of Merrick’s functional abilities available to them was: (i) Merrick’s self-report, (ii) his treating physicians’ records, (iii) the QEEG results, (iv) Dr. Frohwirth’s psychological testing, (v) the results from the Mayo Clinic (including tests and clinical

assessments from Drs. Squires, Daube, Maruta, Ivnik, and Silber), and (vi) Dr. Donaldson's IME report. *See* pages 5-12, *supra*.

Defendants had recognized, correctly, that the QEEG was not a valid tool. *See* page 12, *supra*. Thus, the only evidence that Merrick was totally disabled after June 30, 1994, was Merrick's self-report and the disability certifications of Drs. Rapaport and Epstein, which were predicated on that self-report. But Merrick's subjective report conflicted with the objective evidence of his functional abilities—most of which was provided by Merrick's own doctors.

Dr. Frohwirth's testing showed a full-scale IQ in the high average range, job-suitability skills that were generally average compared to other "top managers," and memory functions that were "similarly adequate * * * except for delayed recall, which is excellent."⁸ ER29-30. Furthermore, Dr. Frohwirth concluded that the limited areas of mild deficiency that he observed on certain subtests may simply be evidence that Merrick has a chronic, now-compensated, learning disability. ER30.

⁸ Although Dr. Epstein opined that Merrick's IQ "was clearly much lower than would have been necessary for the advanced degree and complex and demanding work that Mr. Merrick had done in the past" (ER116), that speculation, especially coming from a psychiatrist rather than a psychologist, should be given no weight. There is no reason to think, nor was there any evidence presented at trial, that people who have "only" a high-average IQ are mentally unfit for work as venture capitalists. On the contrary, the only evidence of comparative IQs in this case was testimony from Dr. Ivnik, the Yale-educated head of Neuropsychology at the Mayo Clinic, that his IQ was one point higher than Merrick's. ER835-36.

At the Mayo Clinic, exercise testing showed that Merrick's "exercise duration is excellent" and "his exercise test results are entirely normal." ER49. Neuropsychological testing showed that Merrick's "general cognitive functioning is high average" with a full-scale IQ of 114 accompanied by a few "mild cognitive inefficiencies" that "may frustrate" Merrick, but "shouldn't represent a major disability for him" because "[h]is worst abilities are 'low average for age' and most of his functioning is mid-to high-average." ER67-69. Moreover, Dr. Ivnik observed that Merrick was probably functioning at the same cognitive level as he always had. *Id.* Finally, Dr. Silber advised Merrick to return to work, albeit at a lower stress level. ER76.

In sum, the functional testing performed on Merrick by his own physicians consistently showed that he was operating at an average or above-average level with a few areas of possible mild deficiency and a few areas of modest excellence. There was nothing to indicate that Merrick was so impaired that he could no longer perform any of his important occupational duties. On the contrary, every valid measure of Merrick's functional abilities suggested that he did not suffer from any disabling mental or physical impairments. Tellingly, none of the doctors who actually tested Merrick's functional abilities found that he was totally disabled

from performing the important duties of his occupation and one of them explicitly advised him to return to work.⁹ See pages 5-12, *supra*.

Thus, for all practical purposes, defendants were faced with a choice between Merrick's self-report and the objective results of testing performed by Merrick's physicians. Even if, in 20/20 hindsight, it was Merrick's self-report, not the testing, that more accurately reflected Merrick's true functional status at the time, the objective evidence of Merrick's functional abilities unquestionably provided "a reasonable basis" for defendants "to take the position that [they] did." *Pioneer*, 863 F. Supp. at 1242. Indeed, during the hearing on the post-trial motions, the district court recognized that the jury's determination of disability "very easily could have gone for the defendant[s]." ER880; *see also* ER871 ("[T]he jury could have gone either way on this. This is not a slam-dunk case * * * where the jury had to go one way it was just so clear."). That being the case, it is impossible to conclude that defendants acted "with knowledge that there [was] no reasonable basis" for their claim determination (*Bartgis*, 969 P.2d at 956).¹⁰ Accordingly, the bad-faith verdict is unsustainable under Nevada law.

⁹ As noted above (at 3-4), even if Merrick needed to reduce his workload or limit his stress level, as Dr. Silber recommended (ER76, 92), he would not be totally disabled under Massachusetts law.

¹⁰ Indeed, Merrick's lead counsel admitted that he initially refused this case because it was an "extremely difficult case" that involved "inconsistent statements

2. Defendants had a reasonable basis for denying Merrick's requests to reopen his claim.

After Merrick's claim was denied, defendants twice reconsidered their decision in light of new information submitted by Merrick. Both times, defendants concluded that the new information did not support Merrick's claim of total disability from his occupation.

In June 1997, defendants received Dr. Cheney's report, which included results for several tests that were designed to detect the physiological markers of CFS, but that offered no credible evidence about Merrick's functional abilities. *See* ER159-67. Notably, none of the three "functional tests" that Dr. Cheney cited ("bicycle ergometry," QEEG, and C-Mind) is a valid indicator of functional ability; indeed, each of these tests was excluded by the district court. *See* pages 13-14, *supra*. And Dr. Cheney's facially absurd conclusion that Merrick could not perform "any type of gainful employment, even the most part-time, sedentary job" (ER166) was directly contradicted by all of the cognitive and physical testing in the record and by Merrick's own statement, a few months before, that he was considering teaching business courses at a local college (ER142). Defendants thus had a reasonable basis to conclude that Dr. Cheney's result-oriented report did not support Merrick's claim.

in the medical records" and because "one of Mr. Merrick's treating doctors" did not believe that Merrick was disabled. ER865.

In March 1999, defendants received the results of psychological testing performed by Dr. Sandman. ER304-31. As defendants' psychological consultant observed, however, "the results of the more traditional neuropsychological tests [performed by Dr. Sandman] are similar to those obtained by Drs. Frohwirth and [Ivnik]; and fall within normal limits (average or better scores)."¹¹ ER395-96. Indeed, contrary to Merrick's account of gradually deteriorating mental faculties, it appeared that his IQ was actually increasing over time, from 108 in 1994, to 114 in 1996, and 118 in 1998. Defendants thus had a reasonable basis for concluding that Dr. Sandman's results did not prove that Merrick was totally disabled.

3. Further evidence at trial confirmed the reasonableness of defendants' decision to deny Merrick's claim.

During their depositions, which were introduced at trial, Merrick's former partners both expressed shock that Merrick was claiming to be disabled. ER825, 839-40. They testified that Merrick's abilities did not decline over time and that Merrick did not demonstrate any significant cognitive or physical impairments between 1991 and 1994 (ER821-22, 826, 840, 845-47), the same time period when, according to Merrick, his condition was progressively worsening to the point of total disability. Indeed, one of Merrick's partners testified that, although they

¹¹ As noted above (at 15-16), the "C-Mind," test, the only test administered by Dr. Sandman on which Merrick displayed significant deficiencies is "not accepted in the [scientific] community" and "is considered to be of no significance." ER805.

forced Merrick out because he was not a good investor, Merrick was perfectly capable of successfully *running* a company.¹² ER841-42. Merrick’s partners also testified that, after they told Merrick that he was being forced out, he repeatedly asked them to reconsider their decision up until the date of the final separation. ER827-28, 839. This testimony refuted Merrick’s self-serving assertions to his physicians and defendants that he decided to sell his share of the partnership in 1993, after realizing that he could not work anymore because of his disability. *See, e.g.*, ER27, 120-21.

Similarly, Dr. Anderson, Merrick’s general practitioner—who treated Merrick from 1989 through late 1995 (ER815), over a year after Merrick says that he became totally disabled—was “as surprised * * * as [he] could possibly be” to learn that Merrick was claiming to be disabled. ER818. Dr. Anderson testified that he never saw any sign that Merrick was suffering from a mental or physical disability during six years as Merrick’s general practitioner. ER816-17.

Furthermore, after litigation had commenced, defendants discovered evidence indicating that Merrick’s self-reports were not merely inaccurate, but may have been intentionally misleading.

¹² Under his policy, Merrick could be able to work in another occupation yet still be totally disabled from his occupation as a venture capitalist. Nevertheless, evidence that he was functionally capable of successfully running a company strongly suggests that he was not so incapacitated that he could no longer perform any of the important duties of a venture capitalist, a closely related profession.

First, Merrick was diagnosed as a malingerer by two forensic psychiatrists: Dr. Rosenberg, who analyzed Merrick's case and interviewed Merrick for defendants on October 1, 2001, in preparation for trial (ER769-95, 799-805) and Dr. Etkoff, who had conducted an IME for Northwestern Mutual, Merrick's other insurer, on September 15 and 16, 1997 (*see* ER794-97). Drs. Rosenberg's and Etkoff's independent diagnoses of malingering were consistent with Dr. Frohwirth's observation, in 1994, that Merrick has a tendency to "magnify the level of experienced illness" (ER27) and "has a vested, [] even if unconscious, motive to appear disabled" (ER30) and with statements by several other doctors expressing concerns about malingering, manipulation, exaggeration, or inexplicable inconsistencies in test results (*see* ER769-95, 799-805).

Second, defendants began to realize that Merrick has a long and broad record of untruthfulness:

- (i) Merrick misrepresented his medical history on his application for insurance, claiming in 1989 that he had never been "treated for or had any known indication of" a mental or emotional disorder (ER2a-b), despite having a history of depression (*see, e.g.*, ER38) and having been on Marplan, an anti-depressant, for several years (*see* ER3, 830, 832-33);

- (ii) Merrick tried to influence his physicians' statements—including asking them to delete certain facts—to better support his disability claim (*see* ER86-90, 270-74, 763-68);
- (iii) Merrick misrepresented the circumstances surrounding a trip to Southeast Asia in 1993, implying that his condition forced him to return home early and that he was bedridden for two weeks afterward (ER750, 757-58, 762, 801), while in fact he stayed the full four weeks that he intended (*see* ER16-17, 24-25, 756), his wife did not recall him returning early or having any complaints upon returning (ER552), Merrick did not mention his alleged bed-ridden status or flu-like symptoms to his general practitioner (ER819), and the only mention of this supposedly devastating trip in Merrick's medical records was his report of having experienced "mild diarrhea" (ER14);
- (iv) from 1996 to 2001, Merrick concealed from his wife an affair involving substantial payments to his mistress and cross-country travel with his mistress during periods when he told his wife that he was resting due to his alleged condition (*see* ER553-72); and
- (v) at trial, Merrick testified that he had lied to his former partners in order to strengthen his bargaining position with them—just, he said, as one does in a courtroom (ER754-55).

Although this evidence did not play a role in defendants' initial decision to deny Merrick's claim, it does help to explain why defendants did not reopen Merrick's claim after litigation had commenced, and it demonstrates the reasonableness of defendants' decision to rely on objective evidence of Merrick's functional abilities rather than Merrick's contrary, subjective self-report.

* * * *

In sum, defendants had a reasonable basis for their decision to deny Merrick's claim. Therefore, the bad-faith verdict must be reversed under Nevada law.

B. Defendants Cannot Be Liable For Punitive Damages.

“Nevada follows the rule that proof of bad faith, by itself, does not establish liability for punitive damages.” *United Fire Ins. Co. v. McClelland*, 780 P.2d 193, 198 (Nev. 1989). To obtain punitive damages under Nevada law, a plaintiff must prove “by clear and convincing evidence” that the defendant “has been guilty of oppression, fraud, or malice, express or implied.” Nev. Rev. Stat. 42.005. Even if the Court upholds the bad-faith verdict, defendants are entitled to JMOL as to punitive liability because their handling of Merrick's claim did not approach the heightened level of reprehensibility—over and above bad faith—required to support such liability.

1. Defendants' handling of Merrick's claim did not involve "oppression, fraud, or malice."

Nevada has defined "oppression" to mean "a conscious disregard for the rights of others which constitutes an act of subjecting plaintiffs to cruel and unjust hardship." *Guaranty Nat'l Ins. Co. v. Potter*, 912 P.2d 267, 273 (Nev. 1996) (internal quotation marks omitted). As the district court recognized, this case involves a legitimate factual disagreement over conflicting evidence regarding Merrick's functional abilities. ER871, 879-80. There is no evidence—much less clear and convincing evidence—that defendants consciously disregarded Merrick's rights; they simply disagreed with Merrick's account of his condition.

Malice "means conduct which is intended to injure a person or despicable conduct which is engaged in with a conscious disregard of the rights or safety of others." Nev. Rev. Stat. 14.001(3). Here, defendants obviously did not intend to injure Merrick. And defendants' conduct was far from "despicable." Indeed, the district court found that the verdict "very easily could have gone for the defendant." ER880. In other words, defendants' handling of Merrick's claim was arguably correct.

Finally, defendants' denial of Merrick's claim did not involve fraud. Defendants considered all of the evidence in the claim file, either submitted by Merrick or gathered by defendants, and concluded that, taken together, the evidence did not support Merrick's claim that he was totally disabled. Defendants

then informed Merrick that they disagreed with his self-report (and with his attending physicians' certifications) and that they would not accept his claim without some objective evidence to support his alleged functional deficiencies. Defendants' assessment of the evidence may have been wrong, but it did not involve anything like fraud.

2. Merrick's "bad company" evidence did not justify punitive liability in this case.

Merrick supplemented his claim for punitive damages with testimony from Stephen Prater, an attorney and self-described insurance industry expert. Prater told the jury, at length, that defendants were bad companies. *See* ER579-693. But his testimony did not provide a basis for punitive liability because, when he finally turned to Merrick's claim (ER693-746), he could not identify any evidence, let alone clear and convincing evidence, that defendants engaged in improper practices. Indeed, Prater identified only four specific "problems" with defendants' handling of Merrick's claim.

First, he said that defendants did not have a reasonable basis to deny Merrick's claim. ER723-24. Of course, even if Prater's view on this issue had some independent evidentiary value, it would establish only bad faith, not punitive liability. But, in any event, Prater's personal, result-oriented opinion is entitled to no weight because this bought-and-paid-for "expert" disregarded the actual medical evidence in the record. *See* pages 5-16, *supra*.

Second, Prater said that defendants' attempt to reach a settlement with Merrick at the end of 1996 (*see* pages 11-12, *supra*) was evidence of an improper "scrub concept" because the claim handler told the field representative to handle the matter on a rush basis before the end of the year. ER727-28. But there is no mention of a "scrub concept" in Merrick's file and there is nothing inherently wrong, or unusual, about a manager pushing to resolve issues expeditiously—especially when defendants had already concluded that the claim would be denied if Merrick did not accept the settlement or provide some information supporting his claim (*see* ER139-40). Prater's speculation that defendants wanted to get the claim off the books by year-end thus does not constitute clear and convincing evidence that defendants acted with oppression, fraud, or malice.

Third, Prater implied that defendants denied Merrick's claim because they concluded that he did not have CFS, which Prater correctly observed is irrelevant under the policy (because it provides benefits for a disability not a diagnosis). *See* ER737-38. But the letter denying Merrick's claim did not even mention CFS and clearly stated that the claim was being denied because, "[b]ased on [a] review of all medical information that has been submitted, as well as the independent Medical Exam from Dr. Donaldson, we find no objective medical documentation which supports an inability to perform the duties of your occupation." ER147; *see also* ER143-46, 154-57.

Finally, Prater said that defendants were wrong to deny Merrick's claim on the basis of the objective evidence in the claim file because the policy "doesn't require objective evidence to establish a subjective problem." ER730-32. But Merrick was not claiming to be disabled by a "subjective problem": Merrick said that he was disabled because he had "significant impairment of intellectual ability" (*i.e.*, neurological deficits) and "fatigue." ER100. The claim file contains substantial objective evidence regarding Merrick's intellectual and physical capabilities. And, as described above (*see* pages 20-25, *supra*), that objective evidence did not support total disability. On the contrary, the evidence showed that Merrick was functioning normally with a few areas of mild deficiency and a few areas of modest excellence.

Defendants obviously do not need a special clause in the policy to authorize consideration of all the evidence in the claim file, both the insured's subjective self-reports and the objective medical evidence relevant to the insured's alleged impairments. Prater's suggestion that this policy obligated defendants to accept whatever Merrick told them, regardless of the other evidence available to them, flies in the face of common sense and should be given no weight.

* * * *

In sum, there is no evidence that defendants were acting with oppression, fraud, or malice when they denied Merrick's claim. The Court accordingly should reverse the award of punitive damages.

II. THE DISTRICT COURT ERRONEOUSLY EXCLUDED EVIDENCE THAT WAS RELEVANT TO PROVE MERRICK'S ACTUAL FUNCTIONAL ABILITIES AND DEFENDANTS' GOOD FAITH.

An insurer does not necessarily stop handling a claim when legal proceedings begin. Indeed, an insurer's willingness to reconsider its earlier denial is evidence of good faith. *See Austero v. Nat'l Cas. Co.*, 84 Cal. App. 3d 1, 35 (1978).

Here, defendants received three sets of new information relevant to Merrick's claim after Merrick filed this lawsuit in 2000. First, defendants received the normative data for the "C-Mind," or "Irvine Memory Battery," test. Defendants had requested this information before Merrick filed suit, but did not receive it until they issued a subpoena to Dr. Sandman. *See* page 15, *supra*. Second, defendants received various records from Merrick's physicians, some of which were duplicative of the records already in the claim file. Third, defendants received a package of materials that included reports from several new physicians evaluating Merrick's functional abilities. ER180-269, 275-303, 332-94. These records were part of the claim file maintained by Northwestern Mutual, Merrick's other disability insurer. All of these documents were referred to defendants'

internal consultants who reviewed them and commented on whether they supported Merrick's claim of total disability. ER451, 455-65, 473-74. The new information and the consultants' comments were placed into Merrick's claim file.

The district court barred defendants from introducing almost all of this evidence at trial, however, having accepted at face-value Merrick's allegation that defendants withheld post-litigation claim-handling documents during discovery.¹³ See ER503-23, 534-51. That allegation was false: defendants had disclosed all post-litigation claim-handling documents at the appropriate time, years before trial. The district court's exclusion of critical evidence based on nothing more than Merrick's unsupported allegation constitutes reversible error.

A. Defendants Did Not Withhold Any Information.

During discovery, Merrick requested any documents "generated as a result of Plaintiff's claim for disability benefits from June 1994 until the present" that were "not contained in the claim file previously produced on August 14, 2000." See ER449 (request number 4). On January 31, 2001, defendants responded by producing responsive documents and objecting "to the extent that [this request] encompasses" privileged or confidential material. *Id.*

¹³ The district court allowed defendants to introduce a few of the records from Merrick's treating physicians, but excluded the C-Mind data, all of the records defendants obtained from Northwestern Mutual, and the reports prepared by defendants' internal consultants. See pages 39-44, *infra*.

Defendants supplemented their disclosure on three occasions. On April 4, 2001, defendants produced the evidence they had obtained from Northwestern Mutual and Merrick's physicians. ER452-54. On July 6, 2001, defendants produced a report by Dr. Cusher, defendants' psychological consultant. ER472. Dr. Cusher's report analyzed the normative data for the "C-Mind" test and all of the records that defendants had obtained from Northwestern Mutual and Merrick's physicians. ER455-65. On September 21, 2001, defendants produced an e-mail from Dr. Cusher to one of defendants' in-house attorneys and a report from Dr. Kaplan (defendants' internal medical consultant) to the person handling Merrick's claim. ER478-79. In the e-mail, Dr. Cusher briefly described his initial reaction to the normative data for the "C-Mind" test. ER451. Dr. Kaplan's report analyzed the records that defendants had obtained from Northwestern Mutual and Merrick's physicians to determine whether they contained evidence that Merrick had a disabling physical impairment.¹⁴ ER473-74.

These documents, along with the Northwestern Mutual file, the records from Merrick's physicians, and the "C-Mind" data, were the entire universe of documents "generated as a result of Plaintiff's claim" that were not contained in the claim file produced on August 14, 2000 (ER449). *See* ER482 ("Defendants have previously produced to Plaintiff all documents responsive to Request No.

¹⁴ Dr. Cusher, who reviewed the records for evidence of a *psychological* impairment, had recommended a medical review. ER473.

4.”). As Mr. Hess, defendants’ outside counsel, declared under penalty of perjury: “[N]o documents responsive to Plaintiff’s discovery requests were withheld from production.” *See* ER493.

Nevertheless, Merrick speculated that defendants had failed to produce responsive documents. He raised two arguments in support of this allegation.

First, Merrick asserted that defendants’ assurance that they had produced all claim-handling documents was “incredible on its face” because there were “only three internal documents” analyzing “more than 3,000 pages of documents” that defendants had received since litigation began. ER497. But those 3,000 pages of documents consisted of only three sets of information: the normative data for the “C-Mind” test, the documents from Merrick’s physicians, and the documents obtained from Northwestern Mutual. Dr. Cusher’s report analyzed all of these materials for evidence of a psychological impairment. *See* ER455-65. And Dr. Kaplan’s report analyzed the Northwestern Mutual documents and the documents from Merrick’s physicians for evidence of a physical impairment. *See* ER473-74. Drs. Cusher and Kaplan both concluded that the new information did not support Merrick’s claim of total disability. *See* ER464-65, 474.

From a claim-handling perspective, there was nothing more for defendants to do. Indeed, although Merrick asserts that defendants’ sworn statement that there are no other documents was “incredible on its face,” he never said what other

documents he thought there might be. Surely, unsupported allegations of this sort cannot justify an implicit finding that defendants' counsel perjured himself.

Second, Merrick argued (ER498) that defendants must have withheld further claim-handling documents because they did not produce any new documents after the Magistrate overseeing discovery held that they had waived any privilege with respect to Merrick's discovery requests by failing to produce privilege logs (*see* ER480). But, as defendants told the district court, with respect to the relevant discovery request (number 4), "Defendants did not produce a privilege log because *Defendants did not withhold any documents responsive to Plaintiff's discovery request on the basis of privilege.*" ER488 (emphasis in original).

Merrick contended that this representation was not believable because litigation over the privilege would not have been necessary had defendants not been withholding documents. ER498. But request number 4 was only one of 18 discovery requests; defendants had objected on the basis of privilege to several of the other requests. *See, e.g.*, ER471. The magistrate's order applied to all 18 requests (*see* ER480) and thus provides no basis for inferring that documents responsive to request number 4 had been withheld.

More important, defendants explicitly told the magistrate that they were not withholding any documents responsive to request number 4 long before the order to produce privilege logs or the order waiving privileges. On May 31, 2001, in

their initial response to Merrick’s motion to compel, defendants told the magistrate that, even though they included a standard objection on the basis of privilege, “Defendants are not in possession of any additional documents responsive to [request number 4]. Accordingly, there is no basis to grant Plaintiff’s request to compel the production of documents relating [to] request [number 4].” ER469; *see also* ER470. Subsequently, defendants supplemented their disclosure with the Northwestern Mutual documents, the records from Merrick’s physicians, the later-generated reports of Drs. Cusher and Kaplan, and the e-mail from Dr. Cusher to defendants’ in-house attorney. *See* page 36, *supra*.

In sum, the record simply does not support an inference that defendants were withholding documents. Certainly there was not evidence sufficient to justify a serious accusation of perjury against defense counsel. The district court’s ruling sanctioning defendants because “the defense failed to turn over their complete post-litigation file” (ER535-36) was thus a clear abuse of discretion.

B. The Exclusion Of This Evidence Was Highly Prejudicial.

The evidence that was erroneously excluded by the district court would have been relevant in at least three significant respects.

1. The excluded evidence was relevant to show Merrick’s true functional abilities.

The excluded evidence strongly suggested that Merrick was *not* “unable to perform the important duties of [his] Occupation” (ER2). If the jury had been

allowed to consider this evidence—and see how the independent results reached by a litany of physicians corroborated defendants’ position—it likely would have concluded that Merrick was not totally disabled.¹⁵ As the district court recognized, this was a close case (*see* ER871, 880) there is no question that this evidence easily could have changed the outcome.

The “C-Mind” normative data. In the pre-litigation claim file (*i.e.*, the portion of the file that was admitted), Dr. Cusher noted that there were inconsistencies between Merrick’s above-average results on “the more traditional neuropsychological tests” administered by Dr. Sandman and his deficient results on the “C-Mind” test, but said that he could not resolve those inconsistencies without the normative data for the “C-Mind” test. ER395. The excluded normative data would have shown that the “C-Mind” test “would likely be considered inadequate for clinical practice and certainly would be inadequate for forensic practice.” *See* ER455. Furthermore, the fact that it took two years and a subpoena for Dr. Sandman to produce data that, when received, invalidated his results may have convinced the jury to view his diagnosis with greater skepticism.

¹⁵ This evidence should have come in as part of defendants’ claim file (along with all the other evidence in the claim file that Merrick had submitted or defendants had gathered). At the very least, defendants’ trial expert, Dr. Rosenberg, should have been allowed to discuss the excluded evidence and rely upon it when rendering his professional opinion regarding Merrick’s functional abilities. *See* Fed. R. Evid. 703; *Walker v. Soo Line R.R.*, 208 F.3d 581, 588 (7th Cir. 2000) (“Medical professionals have long been expected to rely on the opinions of other medical professionals in forming their opinions.”).

Dr. Cusher's report. Dr. Cusher reviewed all of the evidence that defendants had obtained from Merrick's physicians and from Northwestern Mutual, including medical reports by Drs. Etcoff, Athelstan, and Novom, an extensive field interview with Merrick, and a signed statement by Merrick (ER376-80, 91-92). ER455-65. After providing detailed comments on each of these, he concluded:

[B]ecause of the Insured's exaggeration, dissimulation (whether purposeful or not) and variable effort, we do not have a clear understanding of his neuropsychological and emotional functioning as they relate to his occupational functioning. By the nature of his high levels of functioning in most areas, it is doubtful that this functioning is significantly compromised if truly at all. Given the Insured's reported history * * * perfectly normal scores would not necessarily be expected. Likewise, there is an expectation of some low scores on any normal person's protocol. [But] the Insured's performance on the most recent test (Sandman) using traditional and well accepted measures of cognitive functioning were within normal limits.

ER464.

Dr. Kaplan's report. Dr. Kaplan reviewed the same information with an eye to a possible physical disability. ER473-74. He concluded that,

based on the objective medical data * * *, the insured's medical impairments (neurological muscular, chronic fatigue, gastrointestinal) are not of such severity as to preclude him medically from fulfilling the occupational duties of his occupation as they are described. The physical examination has been repeatedly essentially normal.

Id.

Dr. Etcoff's report. Dr. Etcoff, a psychologist, performed a full battery of psychological tests on Merrick over a day-and-a-half in September 1997. ER180-269. Dr. Etcoff filed a written report that incorporated a detailed review of the medical records relevant to Merrick's alleged disability (ER182-95), his own first-hand observations of Merrick (ER200-05), and a careful analysis of the results of testing he had performed on Merrick (ER205-13).¹⁶

At the end of his testing protocol and record review, Dr. Etcoff diagnosed Merrick as a malingerer. ER212. This diagnosis was based on several "symptom validity tests" administered to Merrick. ER209-212. For example, Dr. Etcoff stated that the Portland Digit Recognition Test "is one of the most powerful, peer-reviewed Symptom Validity Tests" because "[a]lthough it appears to patients to be a difficult test, in reality, it is a very simple test to score well upon." ER209. Merrick scored 51 on this test, 6 points worse than the average score for "14 brain injured subjects with IQs averaging 76" and only 6 points higher than the second-worst score out of "110 subjects with brain dysfunction ranging from mild to severe." *Id.* Dr. Etcoff said that "Merrick could not possibly have scored as poorly on this very simple test without conscious and willful intent." *Id.* Dr. Etcoff also reported that Merrick missed 19 out of 20 questions on one sub-test that "is particularly easy to do well upon," whereas a 15-year-old with spinal

¹⁶ Of note, Merrick scored an IQ of 111 (receiving a verbal score of 119 and a performance score of 102). ER207.

meningitis and an IQ of 56 missed only 3 questions on that sub-test. ER210-11. In conclusion, Dr. Etkoff admitted that it is difficult to accurately assess someone who is malingering, but observed that Merrick's "intelligence appears quite intact" and "there do not appear to be any credible organic symptoms that might impede his return to employment." ER212.

Dr. Athelstan's report. After reviewing and analyzing Merrick's medical records, Dr. Athelstan concluded that Merrick "does not have any psychiatric symptoms that would prevent him from returning to his usual occupation, nor does he appear to have any genuine cognitive impairment." ER336. Dr. Athelstan also analyzed Dr. Sandman's report and concluded that Dr. Sandman's "choice of tests was not optimal, his clinical evaluation appeared to lack objectivity, and his interpretations of both the test results and other data appeared to be biased in the direction of supporting [Merrick's] claim of disability. His opinion of disability is not well substantiated." ER335.

Dr. Novom's report. Dr. Novom, a neurologist, reviewed Merrick's medical records and observed that "there is a firm consensus amongst past neuropsychologic studies reaching [the] conclusion [that] Mr. Merrick does not suffer from clinically significant cognitive dysfunction." ER294. (This was before Dr. Sandman's report.) Dr. Novom then concluded that Merrick was "obviously a

bright and capable individual exhibiting no clinical objective signs of physical or * * * neurologic impairment.” ER291.

Northwestern Mutual’s internal medical consultants. Two of Northwestern Mutual’s internal medical consultants reviewed all of the evidence in their claim file and concluded that Merrick was not totally disabled. *See* ER343-46, 374.

2. The excluded evidence was relevant to show that defendants’ denial of Merrick’s claim was in good faith.

Although the jury was charged with evaluating defendants’ good faith, it was not allowed to learn that Northwestern Mutual had independently concluded that Merrick did not suffer from a disabling condition—a conclusion that was supported by the extremely thorough reports of three highly qualified outside consultants, Drs. Etkoff, Athelstan, and Novom, each of whom also concluded that Merrick did not suffer from any substantial impairments. If this evidence had been admitted, the consensus among so many highly qualified specialists that Merrick’s problems did not rise to the level of total disability would have tended to refute any inference that Paul Revere’s decision to terminate Merrick’s claim was unreasonable and made in bad faith.

Indeed, this evidence was especially important in light of the free rein that Prater, Merrick’s “insurance industry expert,” was given to label defendants as renegade companies. *See generally* ER579-693. The fact that another insurer had

independently reached precisely the same conclusion as defendants would have rebutted Prater's opinion that defendants' handling of Merrick's claim violated the standards of the insurance industry.

Moreover, because the excluded evidence shows that defendants were willing to reconsider their denial of Merrick's claim in light of new evidence, it demonstrates defendants' good faith. *See Austero*, 84 Cal. App. 3d at 35.

3. The excluded evidence was relevant to show that defendants complied with their duty of post-litigation claim handling.

Drs. Cusher's and Kaplan's analyses were necessary to establish that defendants had complied with their duty to consider new information after a lawsuit has been filed. Prater made a point of telling the jury that insurers have a continuing duty to consider new information "[e]ven if there's a lawsuit *like in this case* that's filed." ER573-74 (emphasis added); *see also* ER746. Of course, Prater knew full well that the district court had excluded the evidence that defendants had complied with this duty, leaving the false impression that defendants had acted in bad faith by ignoring new evidence that they received during litigation.¹⁷

¹⁷ The prejudice from this ruling was highlighted by one of the jurors, who commented in open court that a substantial reason for the award of punitive damages was that defendants did not further consider Merrick's claim after litigation commenced. *See* ER868. There is no bar to relying on post-trial statements of jurors as evidence of the prejudice caused by errors at trial. *See, e.g., Madrigal v. Bagley*, 276 F. Supp. 2d 744, 776-77 (N.D. Ohio 2003), *aff'd*, 413 F.3d 548 (6th Cir. 2005).

Had defendants' entire post-litigation claim file been admitted—including the new information discussed above and Drs. Cusher's and Kaplan's reviews—it would have demonstrated that defendants received and evaluated new information regarding Merrick's condition and that the new information gave defendants good reason to adhere to the conclusion that Merrick was not totally disabled.

* * * *

Because the exclusion of this evidence was erroneous and extremely prejudicial, a new trial is required.

III. THE DISTRICT COURT ERRONEOUSLY REFUSED TO INSTRUCT THE JURY THAT IT COULD PUNISH DEFENDANTS ONLY FOR CONDUCT THAT AFFECTED MERRICK.

As noted above (at 31-33), Merrick's case for punitive damages relied on testimony from Stephen Prater. Prater described an alleged history of improper claim-handling practices and told the jury that defendants had been using these practices on disability policies like Merrick's for the past decade. *See* ER575-78; *see generally* ER579-693. Because Merrick's reliance on Prater's testimony created a real possibility that the jury would punish defendants for this entire alleged history of wrongdoing, defendants sought the following instruction:

In deciding whether or in what amount to award punitive damages, you may consider only the specific conduct by Defendants that injured Plaintiff. You may not punish Defendants for conduct or practices that did not affect Plaintiff, even if you believe that such conduct or practices were wrongful or deserving of punishment. The law provides other means to punish wrongdoing unrelated to Plaintiff.

ER501. Defendants had a right to this instruction, but the district court refused to give it. ER806-07, 812-13.

The Supreme Court has emphasized the limited scope of punitive damages, admonishing courts that:

A defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business. Due process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties' hypothetical claims against a defendant * * *.

State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 423 (2003).¹⁸ Of course, this does not mean that evidence of general corporate practices or conduct is inadmissible to provide context, prove intent, or demonstrate recidivism. But—because due process does not permit defendants to be punished for actions that did not harm the plaintiff—when such evidence is admitted, the jury must be told that it can consider the evidence for these limited purposes but cannot punish the defendant for any conduct that did not affect the plaintiff.

Such instructions are particularly important in light of the Supreme Court's concern that courts too often rely on “[v]ague instructions” in the punitive-damages context that “do little to aid the decisionmaker in its task of assigning appropriate weight to evidence that is relevant and evidence that is tangential or

¹⁸ This limitation is independent of and distinct from *State Farm's* prohibition on punishment for “out-of-state conduct * * * that was lawful in the jurisdiction where it occurred.” *Id.* at 422.

only inflammatory.” *Id.* at 418. Thus, in cases such as this, where extensive “bad-company” evidence is admitted, the jury must be clearly instructed that it is allowed to punish defendants only for “the conduct that harmed the plaintiff.”

This principle implicates the fundamental doctrine that courts are empowered to decide only the specific case and controversy before them. *See* U.S. Const. art. III, § 2. If Merrick had introduced evidence of another insured’s similar claim in an attempt to prove that defendants are recidivists (he did not), the jury would *not* have been authorized to return a verdict finding that defendants acted in bad faith when handling the other claim and awarding damages for that conduct: Even if evidence of the other claim was relevant to this case, the claim itself would not be part of the “case and controversy” before the court and could not form the basis of the jury’s verdict.

But that is exactly what happened here. The jury was allowed to judge and award damages for the decade of allegedly bad-faith conduct described by Prater. By failing to give defendants’ proposed instruction, the district court allowed the jury to enter a verdict that reached issues outside the case and controversy before the court in violation of fundamental constitutional limits on judicial authority.

In fact, for all that anyone can tell, the jury may have concluded that defendants’ handling of Merrick’s claim did not merit punitive damages at all. Because it was not properly instructed, the jury may have imposed \$10,000,000 as

punishment for the historical practices described at length by Prater. Indeed, the fact that the jury assigned only one-fifth of the punitive award to Paul Revere, the company that sold Merrick his policy and denied Merrick's claim, strongly suggests that the \$8,000,000 punitive award against UnumProvident was, to a large extent, intended to punish it for being an "unsavory business[]" rather than for its very limited role in the handling of Merrick's claim.¹⁹

In sum, the district court's refusal to give defendants' proposed instruction was erroneous and extremely prejudicial. The Court should grant defendants a new trial on punitive damages in which the jury is appropriately instructed.

IV. THE PUNITIVE AWARD IS GROSSLY EXCESSIVE.

Although in a world of nine-digit lottery prizes and eight-digit athletic salaries a punitive award of \$10,000,000 might not seem shocking, it is important to remember that punitive damages are the civil equivalent of criminal punishment. Indeed, the Supreme Court has concluded that a \$2,000,000 punitive award is "tantamount to a severe criminal penalty" (*BMW of N. Am., Inc. v. Gore*, 517 U.S.

¹⁹ Paul Revere first told Merrick that it was questioning his claim on the basis of the objective evidence of his functional abilities in January 1996, following Dr. Donaldson's IME. ER131. That was three months before the acquisition of Paul Revere by Provident Companies, Inc. was even announced. ER615. And Paul Revere denied Merrick's claim in January 1997 (ER153), two months before the acquisition was finalized (ER617). In other words, there is no reason to think that Paul Revere's acquisition by Provident Companies, Inc. (n/k/a UnumProvident) had an impact on the handling of Merrick's claim. Nevertheless, the jury assigned 80% of the punitive award to UnumProvident, the company excoriated by Prater, rather than Paul Revere.

559, 585 (1996)), and thus is unconstitutional unless the defendant is guilty of “egregiously improper conduct” (*id.* at 580). It goes without saying, therefore, that a \$10,000,000 punishment can be justified only for outrageously improper conduct.

In order to prevent the improper imposition of such massive punishments and counteract “the imprecise manner in which punitive damages systems are administered” (*State Farm*, 538 U.S. at 417), the Supreme Court has instructed lower courts to consider three “guideposts” when determining whether a punitive award is unconstitutionally excessive: (1) the degree of reprehensibility of the defendant’s conduct; (2) the ratio of punitive to compensatory damages; and (3) the civil penalties applicable to comparable conduct (*BMW*, 517 U.S. at 575-76). The Court repeatedly has “reiterated the importance of these three guideposts” and has indicated that “[e]xacting” judicial review employing these guideposts is necessary to “ensure[] that an award of punitive damages is based upon an application of law, rather than a decisionmaker’s caprice.” *State Farm*, 538 U.S. at 418 (internal quotation marks omitted).

Here, the required “[e]xacting” review compels the conclusion that a \$10,000,000 punitive award, the equivalent of a very severe criminal penalty, is clearly grossly excessive. Under the *BMW* guideposts, as refined in *State Farm*, the constitutional maximum permissible punitive award in this case is no more than the amount of economic damages—\$1,147,355.

Indeed, even apart from *BMW*'s guideposts, the punitive award should be reduced in light of the district court's conclusion that the underlying liability verdict "very easily could have gone for the defendant[s]" (ER880). As the Seventh Circuit has recognized, "[t]he heavier the sanction, the more confidence there should be that it is justified * * * [s]o if there is doubt about justification, but not enough to warrant reversal, a sensible response is to cut down the sanction." *Ampat/Midwest, Inc. v. Ill. Tool Works Inc.*, 896 F.2d 1035, 1044 (7th Cir. 1990) (citations omitted). Although it is defendants' position that punitive damages are not appropriate at all when the decision to deny a claim is supported by enough evidence that a jury "very easily" could have judged the denial to be *correct* (see pages 29-34, *supra*), at the very least, the doubt created by such evidence should result in a much smaller punitive award.

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

"The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." *State Farm*, 538 U.S. at 419 (internal quotation marks and alterations omitted). Put succinctly, "punitive damages may not be grossly out of proportion to the severity of the offense." *BMW*, 517 U.S. at 576 (internal quotation marks omitted).

In *State Farm*, the Supreme Court instructed lower courts to consider five factors when assessing the degree of reprehensibility of a defendant's conduct: (i)

whether “the harm caused was physical as opposed to economic”; (ii) whether “the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others”; (iii) whether “the target of the conduct had financial vulnerability”; (iv) whether “the conduct involved repeated actions or was an isolated incident”; and (v) whether “the harm was the result of intentional malice, trickery, or deceit, or mere accident.” 538 U.S. at 419. Importantly, the Court added, “[t]he existence of any one of these factors weighing in favor of a plaintiff may not be sufficient to sustain a punitive damages award; and the absence of all of them renders any award suspect.” *Id.*

Here, none of the five reprehensibility factors is present. Accordingly, assuming that defendants’ conduct crossed the threshold for punitive liability at all, it surely falls on the far low end of the reprehensibility spectrum.

First, defendants obviously did not physically injure Merrick.

Second, defendants did not disregard a risk to Merrick’s health.

Third, Merrick is not financially vulnerable. On the contrary, he is a highly educated and sophisticated businessperson with assets sufficient to own million-dollar residences, travel internationally, and carry on a cross-country affair involving payments of tens-of-thousands of dollars per year to his mistress without his wife’s knowledge. Indeed, Merrick testified that he had received \$2-3 million from his partnership since leaving (ER747) and expected to receive another

\$800,000 to \$1,200,000 within the next two years (ER748).

In any event, Merrick cannot plausibly claim that defendants *targeted* him because he was vulnerable, that is, among “the weakest of the herd—the elderly, the poor, and other consumers who are least knowledgeable about their rights and thus most vulnerable to trickery or deceit.” *State Farm*, 538 U.S. at 433 (Ginsburg, J., dissenting) (quotation marks omitted); *see also BMW*, 517 U.S. at 576 (“infliction of economic injury, especially when * * * the *target* is financially vulnerable, can warrant a substantial penalty”) (emphasis added). Unlike in other cases in which this factor has been invoked as a justification for a substantial punitive award, there is no evidence that defendants were motivated by Merrick’s lack of resources. *Cf. Neibel v. Trans World Assurance Co.*, 108 F.3d 1123, 1126 (9th Cir. 1997) (finding scheme to prey on “Joe Lunch Buckets” sufficiently reprehensible to justify a \$500,000 punitive award); *Life Ins. Co. of Ga. v. Johnson*, 701 So. 2d 524, 526-29 (Ala. 1997) (reducing \$15,000,000 punishment to \$3,000,000 where defendant engaged in a pattern of selling worthless Medicare supplement policies to “elderly, uneducated, single black women”).

Fourth, there was no evidence of “repeated misconduct of the sort that injured [Merrick].” *State Farm*, 538 U.S. at 423. Though Prater regaled the jury with the same kind of “bad-company” testimony that he employed in *State Farm*, he offered no testimony about the handling of any specific claim other than

Merrick's.²⁰ In *State Farm*, the Supreme Court determined that Prater's generalized testimony about corporate practices did not amount to evidence of conduct "similar to that which harmed [the plaintiff]." *Id.* at 424. Similarly, Prater's testimony in this case was inadequate for this purpose and consequently, just as in *State Farm*, the "repeated misconduct" factor is absent here.

Fifth, there was no evidence of "intentional malice, trickery, or deceit." *Id.* at 419. At most, under Merrick's theory of the case, defendants' denial of Merrick's claim reflected an improper demand for objective evidence of his allegedly disabling condition and an overly skeptical view of his self-report. But defendants' reliance on abundant objective proof rather than a conflicting subjective report is not the type of inherently malicious or deceitful act that would satisfy this reprehensibility factor.

Moreover, on the other side of the ledger, there is much mitigating evidence. To begin with, defendants paid Merrick \$288,000 in disability benefits while they conducted a thorough examination and review of all evidence relating to his claim—including several months during which they waited for new information to

²⁰ In *State Farm*, the Supreme Court was highly critical of Prater's "tangential" and "inflammatory" evidence of "dissimilar" conduct "that bore no relation to the Campbells' harm," but instead merely encouraged the jury to punish the defendant for being "an unsavory * * * business." 538 U.S. at 410, 418, 422, 423; *see also Campbell v. State Farm. Mut. Auto. Ins. Co.*, 65 P.3d 1134, 1159-61 (Utah 2001) (identifying Prater as the witness purveying this evidence), *rev'd and remanded*, 538 U.S. 408 (2003).

be submitted by Merrick. *See* page 12, *supra*. And defendants’ decision to deny Merrick’s claim was hardly arbitrary or outrageously wrong: As the district court found, the verdict in this case “very easily could have gone for the defendant.” ER879-80. If a decision can be “egregiously improper” even though it “very easily” could have been judged to be *correct*, then the first guidepost is worthless.

In short, if defendants’ conduct crossed the threshold of reprehensibility necessary for the imposition of punitive damages, it did so by only the slimmest of margins. There can be no serious doubt on this record that defendants’ conduct did not warrant the imposition of \$10,000,000 in punitive damages—five times the amount the Supreme Court analogized to a “severe criminal penalty” in *BMW*.

B. The 6:1 Ratio Of Punitive To Compensatory Damages Is Indicative of Excessiveness.

In *State Farm*, the Supreme Court undertook to provide lower courts with more detailed guidance regarding the ratio guidepost than it had supplied in previous cases. Specifically, the Court reiterated its prior statement that a punitive award of four times compensatory damages was likely to “be close to the line of constitutional impropriety” and indicated that, though “not binding,” the 700-year-long history of double, treble, and quadruple damages remedies (*i.e.*, ratios of 1:1 to 3:1) is “instructive.” 538 U.S. at 425; *see also Planned Parenthood of the Columbia/Willamette Inc. v. Am. Coalition of Life Activists*, 422 F.3d 949, 962 (9th Cir. 2005) (“in cases where there are significant economic damages and punitive

damages are warranted but behavior is not particularly egregious, a ratio of up to 4 to 1 serves as a good proxy for the limits of constitutionality”). More important for present purposes, however, as this Court has recognized, *State Farm* “emphasizes and supplements” *BMW* “by holding that ‘[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee.’” *Bains LLC v. Arco Prods. Co.*, 405 F.3d 764, 776 (9th Cir. 2005) (quoting *State Farm*, 538 U.S. at 425).

To be sure, these principles do not establish a rigid mathematical formula for calculating punitive damages, but instead create a “rough framework” (*Planned Parenthood*, 422 F.3d at 962), under which the maximum permissible ratio depends principally on two variables: the degree of reprehensibility of the conduct and the magnitude of the harm caused by the conduct (here, as in most cases, the amount of the compensatory damages). The maximum permissible ratio is directly related to the former and inversely related to the latter. In other words, for any particular amount of compensatory damages, the lower on the reprehensibility spectrum the conduct falls, the lower the constitutionally permissible ratio. And for any particular degree of reprehensibility, as the compensatory damages increase, the maximum permissible ratio decreases.

Application of this commonsense framework compels the conclusion that the ratio of punitive to compensatory damages in this case—6:1 (\$10,000,000 to \$1,647,355)—is excessive.²¹

To begin with, there can be no question that, if punishable at all, defendants' conduct was on the lowest end of the reprehensibility spectrum. Indeed, defendants' conduct plainly is far less egregious than the conduct in *State Farm* itself, in which the defendant was found to have deliberately deceived vulnerable senior citizens—altering their claim file and first assuring them that they had no risk of liability, then insisting that they pay the excess judgment even if that meant selling their home. 538 U.S. at 413, 419.

Moreover, like the compensatory award in *State Farm*, Merrick's compensatory award of \$1,647,355 “was substantial,” constitutes “complete compensation” for Merrick's alleged harm, and, because it includes a large amount for emotional distress (\$500,000), almost certainly contains “a component which was duplicated in the punitive award.” *Id.* at 426.

²¹ Although the jury assigned part of the punitive award to each of the defendants, the constitutional excessiveness analysis applies to the aggregate award. *Planned Parenthood*, 422 F.3d at 963-64 (calculating maximum constitutional punitive award against multiple defendants by aggregating total punitive and compensatory awards and assigning maximum aggregate amount to individual defendants pro rata). Moreover, considering the aggregate award makes sense here because both defendants are being punished for a single event, the denial of Merrick's claim.

Accordingly, taking into account both the low reprehensibility of defendants' conduct and the substantial size of Merrick's compensatory damages, which included a substantial emotional-distress award, the conclusion is inescapable that a ratio in excess of 1:1 is constitutionally unsustainable. *See id.* at 429 (in view of "the substantial compensatory damages," State Farm's conduct likely would justify "a punitive damages award at or near the amount of compensatory damages"); *Bach v. First Union Nat'l Bank*, 149 F. App'x 354, 366 (6th Cir. 2005) (holding that a 6.6:1 ratio "is alarming, especially considering the fact that much of the [\$400,000] compensatory damage award must be attributable to [the plaintiff's] pain and suffering" which "compels the conclusion that the punitive damage award is duplicative"); *Romo v. Ford Motor Co.*, 6 Cal. Rptr. 3d 793, 804 (Cal. Ct. App. 2003) ("we must look at the *nature* of the compensatory damages award, with the result that a lower multiplier will be appropriate if the compensatory damages award for the particular tort already compensates for the 'outrage and humiliation' that punitive damages are primarily intended to condemn") (quoting *State Farm*, 538 U.S. at 426) (emphasis in original).

The Eighth Circuit recently reached this result in a case in which the plaintiff, a victim of the defendant's racial harassment, was awarded \$600,000 in compensatory damages and over \$6,000,000 in punitive damages. *Williams v. ConAgra Poultry Co.*, 378 F.3d 790 (8th Cir. 2004). The defendants' conduct in

Williams was particularly reprehensible: the plaintiff's supervisor "regularly swore at him and berated him in front of other employees" and "treated [the plaintiff] and other black employees with special scorn"; the supervisor and other employees "regularly used racially demeaning language around [the plaintiff]"; "there was a pervasive practice of using a double standard for evaluating and disciplining white and black employees"; "white managers were extended privileges, like travel at company expense, unavailable to black employees"; and "black employees were given shorter breaks than white employees." *Id.* at 795, 798. Nevertheless, the Eighth Circuit held that a 1:1 ratio of punitive to compensatory damages was the most that was permitted under *State Farm*, explaining:

[The plaintiff's] large compensatory award * * * militates against departing from the heartland of permissible exemplary damages. The Supreme Court has stated that "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee." [The plaintiff] received \$600,000 to compensate him for his harassment. Six hundred thousand dollars is a lot of money. Accordingly, we find that due process requires that the punitive damages award on [his] harassment claim be remitted to \$600,000.

Id. at 799 (citation omitted).

Williams is no aberration. The Eighth Circuit again drew the line at a 1:1 ratio in *Boerner v. Brown & Williamson Tobacco Co.*, 394 F.3d 594 (8th Cir. 2005). There, the court ordered a remittitur of a \$15,000,000 punitive award to

\$5,000,000, approximately a 1:1 ratio, even while concluding that the defendant's conduct "was highly reprehensible":

[T]he sale of this defective product occurred repeatedly over the course of many years despite [the defendant's] knowledge that the product was dangerous to the user's health; and [the defendant] actively misled consumers about the health risks associated with smoking. Moreover, the reprehensible conduct was shown to relate directly to the harm suffered by [the plaintiff]: a most painful, lingering death following extensive surgery.

Id. at 602-03. Despite that severe assessment of the defendant's conduct, the court held that "a ratio of approximately 1:1 would comport with the requirements of due process" because of the substantial compensatory award and because "[f]actors that justify a higher ratio, such as the presence of an 'injury that is hard to detect' or a 'particularly egregious act [that] has resulted in only a small amount of economic damages,' are absent here." *Id.* at 603 (quoting *BMW*, 517 U.S. at 582) (second alteration in original); *see also Watson v. E.S. Sutton, Inc.*, 2005 WL 2170659, at *19 (S.D.N.Y. Sept. 6, 2005) (reducing punitive damages from \$2,500,000 to \$717,000 in employment discrimination case where compensatory damages were \$1,500,000 because "the Court does not believe that this is a case with the most culpable conduct possible"); *Czarnik v. Illumina, Inc.*, 2004 WL 2757571, at *11 (Cal. Ct. App. Dec. 3, 2004) (unpublished) (reducing \$5,000,000 punitive award to \$2,200,000 because "the \$2.2 million compensatory damage award was without question 'substantial' and, in light of the fact that [the

defendant's] conduct was not highly reprehensible * * * we conclude that a 1:1 ratio of punitive to compensatory damages is the maximum award that is sustainable against a due process challenge”).

The decisions in *Williams* and *Boerner* are compelling here. To paraphrase the Eighth Circuit, \$1,647,355 “is a lot of money” (*Williams*, 378 F.3d at 799). And, with respect to reprehensibility, defendants’ denial of Merrick’s disability claim is not even in the same league as racially harassing a subordinate or fraudulently concealing the health risks of a potentially deadly product. Accordingly, if 1:1 is the highest constitutionally permissible ratio for the conduct at issue in *Williams* and *Boerner*, then 1:1 also is the highest constitutionally permissible ratio here.²²

Indeed, because Merrick’s compensatory award contains a significant amount for emotional distress (\$500,000), a 1:1 ratio to the total compensatory damages exceeds the amount necessary to punish and deter.

²² Merrick will no doubt invoke *Hangarter v. Provident Life & Accident Insurance Co.*, 373 F.3d 998 (9th Cir. 2004), in which this Court upheld a \$5,000,000 punitive award against Paul Revere, Provident Life & Accident, and UnumProvident, which was 2.6 times the plaintiff’s compensatory damages. In *Hangarter*, however, the panel found four of the five reprehensibility factors identified in *State Farm* to be present. *See id.* at 1014. Although defendants disagree with that conclusion, the presence of four reprehensibility factors readily serves to distinguish this case from *Hangarter*. In any event, the 6:1 ratio here is materially higher than the 2.6:1 ratio in *Hangarter*.

In *State Farm*, the Supreme Court recognized that compensatory damages have a deterrent effect in their own right, admonishing that “punitive damages should only be awarded if the defendant’s culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence.” 538 U.S. at 419; *see also Memphis Cmty. Sch. Dist. v. Stachura*, 477 U.S. 299, 307 (1986) (“[d]eterrence * * * operates through the mechanism of damages that are *compensatory*”). And when those compensatory damages include a large amount for non-economic harms, “there is no clear line of demarcation between punishment and compensation and a verdict for a specified amount frequently includes elements of both.” *Id.* at 426 (quoting Restatement (Second) of Torts § 908, cmt. c (1977)).

Here, because the economic damages alone serve to erase defendants’ gain from the denial of Merrick’s claim, every penny of the substantial emotional-distress award necessarily has a deterrent effect. Accordingly, a punitive award equal to the full amount of compensatory damages is excessive, and instead a punishment in the amount of the past benefits awarded to Merrick—\$1,147,355—should be considered the constitutional maximum.

If it is allowed to stand (*but see* Part V, *infra*), the \$500,000 award of attorneys’ fees provides further reason to conclude that a punitive award equal to

the amount of economic damages is more than sufficient to punish and deter. Because attorneys' fees "include[] a certain punitive element" (*Parrish v. Sollecito*, 280 F. Supp. 2d 145, 164 (S.D.N.Y. 2003)), a plaintiff who receives a substantial award of attorneys' fees should receive "a lesser rather than greater award of punitive damages" (*Daka, Inc. v. McCrae*, 839 A.2d 682, 701 n.24 (D.C. Ct. App. 2003)).

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

The third *BMW* guidepost requires a comparison between "the punitive damages award and the civil or criminal penalties that could be imposed for comparable misconduct." 517 U.S. at 583. In this case, the relevant penalty is found in Chapter 686A.183 of the Nevada Revised Statutes. The Nevada legislature has fixed the maximum civil penalty for an insurer who "knew or reasonably should have known" that it was violating the provisions of Nevada's insurance code at \$5,000.²³ Nev. Rev. Stat. 686A.183. Because the \$10,000,000 aggregate punitive award in this case is **2000 times** the maximum civil penalty that would be allowed under Nevada law for comparable (or, indeed, more egregious) insurer misconduct, the third guidepost confirms that the award is grossly excessive.

²³ Notably, however, the jury found that Paul Revere did *not* violate that statute. (It was not asked whether the statute was violated by UnumProvident.) See ER862-63.

V. THE AWARD OF ATTORNEYS' FEES SHOULD BE VACATED.

A. Under Nevada Law, Attorneys' Fees May Be Awarded Only For Frivolous Claims Or Defenses.

Nevada has “severely restricted the discretion of the court in granting attorneys’ fees.” *Swallow Ranches, Inc. v. Bidart*, 525 F.2d 995, 999 (9th Cir. 1975). Under Nevada law, attorneys’ fees may be awarded only if they are expressly authorized by statute, rule, or agreement between the parties. *First Interstate Bank v. Green*, 694 P.2d 496, 498 (Nev. 1986).

Merrick sought attorneys’ fees under Nev. Rev. Stat. 18.010(2)(b), which authorizes an award of fees to a prevailing party only “when the court finds that the claim or defense of the opposing party was brought or maintained without reasonable ground or to harass the prevailing party.” Although the statute says that courts should “liberally construe the provisions of this paragraph in favor of awarding attorneys’ fees in all appropriate situations,” it defines the appropriate situations narrowly: “It is the intent of the Legislature that the court award attorneys’ fees pursuant to this paragraph and impose sanctions pursuant to Rule 11 of the Nevada Rules of Civil Procedure in all appropriate situations to punish for and deter frivolous or vexatious claims and defenses.” Nev. Rev. Stat. 18.010(2)(b).

The linkage of attorneys’ fees under Nev. Rev. Stat. 18.010(2)(b) and sanctions under Nevada’s Rule 11 is not accidental: “[T]he analysis required

under NRS 18.010(2)(b)” is “similar to” the test for frivolous litigation that warrants sanctions under Nevada’s Rule 11. *Bergmann v. Boyce*, 856 P.2d 560, 564 (Nev. 1993). Thus, a defendant’s decision to put the plaintiff to his proof at trial justifies an award of attorneys’ fees only if its defense is “not supported by any credible evidence at trial.”²⁴ *Barozzi v. Benna*, 918 P.2d 301, 303 (Nev. 1996).

B. The District Court Misinterpreted Nevada Law.

Defendants opposed Merrick’s request for attorneys’ fees because their position at trial was far from frivolous. The district court agreed, finding that “the jury could have gone either way on this. This is not a slam-dunk case * * * where the jury had to go one way it was just so clear.” ER871. That finding should have been dispositive: Because defendants’ position was supported by credible evidence, attorneys’ fees are not available under Nev. Rev. Stat. 18.010(2)(b).

Merrick did not challenge the district court’s assessment of the evidence, but instead argued that attorneys’ fees are available automatically in every insurance bad-faith case under *Farmers Home Mutual Insurance Co. v. Fiscus*, 725 P.2d 234 (Nev. 1986). The district court accepted Merrick’s argument, and awarded \$500,000 in fees, acknowledging that, “[w]ithout the *Fiscus* case, I don’t think I

²⁴ To be clear, the availability of attorneys’ fees does not turn on an assessment of defendants’ denial of Merrick’s claim. Attorneys’ fees are sanctions for “frivolous or vexatious *claims and defenses*” (Nev. Rev. Stat. 18.010(2)(b) (emphasis added)), not for the conduct underlying the lawsuit. The relevant question is whether defendants presented any credible evidence to support their position at trial.

would award attorneys' fee[s] in this case because * * * the case could have gone either way" and "very easily could have gone for the defendant[s]." ER879-80.

But *Fiscus* did not create a categorical rule that attorneys' fees are awardable automatically in every bad-faith case. Indeed, under Nevada law, a court may not create a new entitlement to attorneys' fees; it may only apply the existing statutes, rules, or agreements between the parties to the facts of the case. See *Green*, 694 P.2d at 498. And that is exactly what *Fiscus* did, concluding that ***on the specific facts of the case*** a finding of bad faith was equivalent to a finding that the defendants' position at trial was frivolous (and that attorneys' fees were thus justified under Nev. Rev. Stat. 18.010(2)(b)).

In *Fiscus*, a hazard insurer denied a homeowner's claim for loss of personal property, citing an exclusion for damage caused by water seepage. 725 P.2d at 235. But the water-seepage exclusion was listed only under the real property coverage in the policy. After a bench trial, the district court found that "Farmers wrongfully denied coverage under a policy exemption that was clearly inapplicable to this claim." *Id.* at 235. When considering attorneys' fees, the court noted that Farmers had tried to defend the case by relying on exactly the same groundless legal interpretation of the policy, so that "a finding of bad faith against the insurance company [for its original denial] was at least tantamount to finding that [its] defense was maintained without reasonable ground." *Id.* at 237. In other

words, because the district court already had determined that Farmers' invocation of the water-seepage exclusion was frivolous, there was nothing left to decide under Nev. Rev. Stat. 18.010(2)(b).

Here, by contrast, when the jury determined that defendants had denied Merrick's claim in bad faith, it did not (explicitly or implicitly) find that there was no evidence to the contrary. Neither did the district court find that defendants had failed to produce any credible evidence at trial. On the contrary, the court found that the verdict "very easily could have gone for the defendant[s]." ER880. In other words, unlike in *Fiscus*, the bad-faith verdict here was *not* "tantamount to finding that [defendants'] defense was maintained without reasonable ground" (725 P.2d at 237).

Because the bad-faith verdict in this case did not resolve the question whether attorneys' fees are appropriate under Nev. Rev. Stat. 18.010(2)(b), *Fiscus* is inapposite. The district court should have applied Nev. Rev. Stat. 18.010(2)(b) to the facts of this case as it saw them. Had it done so, it would have denied Merrick's request. *See* ER879-80. The award of attorneys' fees—entered in misplaced reliance on *Fiscus*—is erroneous and should be vacated as a matter of law.

CONCLUSION

The Court should reverse the findings of liability for bad faith and punitive damages. Alternatively, the Court should grant defendants a new trial on all issues in which they are allowed to present the erroneously excluded evidence of post-litigation claim handling. Failing that, the Court should grant defendants a new trial on punitive damages in which the jury is appropriately instructed. At minimum, the Court should reduce the punitive award to no more than the amount of economic damages and reverse the award of attorneys' fees.

Respectfully submitted.

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