No. 06-2410

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

DEBORAH GALARNEAU,

Plaintiff-Appellee,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED,

Defendant-Appellant.

On Appeal from the
United States District Court
for the District of Maine

CORRECTED BRIEF OF DEFENDANT-APPELLANT

James R. Erwin
PIERCE ATWOOD LLP
One Monument Square
Portland, ME 04101
(207) 791-1100 (phone)
(207) 791-1350 (fax)

Eugene Volokh
UCLA SCHOOL OF LAW
405 Hilgard Avenue
Los Angeles, CA 90095
(310) 206-3926 (phone)

Evan M. Tager
Andrew Tauber
MAYER, BROWN, ROWE & MAW LLP
1909 K Street, N.W.
Washington, DC 20006
(202) 263-3000 (phone)
(202) 263-3300 (fax)

Counsel for Merrill Lynch, Pierce, Fenner & Smith Incorporated

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Defendant-Appellant Merrill Lynch, Pierce, Fenner & Smith Incorporated discloses that it is a wholly-owned subsidiary of Merrill Lynch & Company, Inc. No other publicly held corporation owns 10% or more of its stock, and it is not the parent of any publicly owned companies.

TABLE OF CONTENTS

Page

Corporate Disclosure Statement i

Table of Contents ii

Table of Authorities v

Jurisdictional Statement 1

Issues Presented 1

Statement of the Case 3

Statement of Facts 3

1. Merrill Lynch warns Galarneau not to engage in active bond trading. 3

2. A customer complaint alerts Merrill Lynch that Galarneau had again engaged in inappropriate bond trading. 4

3. Merrill Lynch's internal investigation confirms that Galarneau engaged in inappropriate bond trading. 7

4. Galarneau is terminated for inappropriate bond trading and for utilizing time and price discretion. 11

5. Merrill Lynch complies with its regulatory obligation to report the reasons for Galarneau's termination. 12

6. Proceedings below. 14

   (a) The district court excludes all evidence of Galarneau's request that the U-5 state that she had been terminated for bond trading that was "not appropriate." 14

   (b) The evidence introduced at trial confirms that Galarneau was fired for inappropriate bond trading. 15

   (c) The jury verdict and post-trial motion. 19

Summary of Argument 20

Standard of Review 23

TABLE OF CONTENTS (CONTINUED)

Page

Argument....................25

I. THE EVIDENCE WAS INSUFFICIENT TO SUPPORT PLAINTIFF'S DEFAMATION CLAIM. 25

A. The Defamation Verdict Cannot Stand Because The U-5 Was Truthful. 25

B. The Defamation Verdict Cannot Stand Because Merrill Lynch Did Not Act With Malice. 28

1. The U-5 was conditionally privileged. 28

2. Merrill Lynch did not act with ill will, and neither knew of nor recklessly disregarded the statement's purported falsity. 30

II. THE DISTRICT COURT ERRED IN EXCLUDING EVIDENCE RELATING TO THE DRAFTING OF THE U-5....................33

A. Evidence Relating To The Drafting Of The U-5 Was Not Excludable Under Rule 408. 34

1. The communications were not offers to settle a disputed claim. 34

(a) There was no offer of valuable consideration. 35

(b) There was no disputed claim. 36

2. The evidence was in any event admissible because it was offered to prove Merrill Lynch's state of mind. 37

3. Excluding evidence of Galarneau's proposed U-5 language gave her an unfair litigation advantage in contravention of the rule's purposes. 39

B. Evidence Relating To The Drafting Of The U-5 Was Not Excludable Under Rule 403. 41

III. THERE WAS INSUFFICIENT EVIDENCE THAT GALARNEAU'S LOST WAGES WERE CAUSED BY THE ALLEGEDLY DEFAMATORY STATEMENT....................43

IV. THE EVIDENCE WAS INSUFFICIENT TO SUPPORT LIABILITY FOR PUNITIVE DAMAGES 45

TABLE OF CONTENTS (CONTINUED)

Page

V. THE PUNITIVE DAMAGES ARE UNCONSTITUTIONALLY EXCESSIVE. 48

A. Merrill Lynch's Alleged Conduct Was Not Sufficiently Reprehensible To Merit A Punitive Award Of Over $2 Million. 49

B. The Ratio Of Punitive To Compensatory Damages Is Unreasonable Given The Size Of The Compensatory Award. 52

C. Comparison With Other U-5 Defamation Cases Demonstrates The Excessiveness Of This Punitive Award. 54

D. A Large Punitive Award Would Frustrate The Public Interest In Accurate Filings Regarding The Conduct Of Securities Brokers. 56

E. The Punitive Award Should Be Substantially Reduced........ 57

Conclusion 58

Certificate of Compliance 59

Certificate of Service 60

TABLE OF AUTHORITIES

Page(s)

CASES

Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413 (S.D.N.Y. 2000) 29, 56

Alicea Rosado v. Garcia Santiago, 562 F.2d 114 (1st Cir. 1977) 53

BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996) .... *passim*

Baker v. Charles, 919 F. Supp. 41 (D. Me. 1996) 30

Ballard v. Wagner, 877 A.2d 1083 (Me. 2005) 31

Bankcard Am., Inc. v. Universal Bancard Sys., 203 F.3d 477 (7th Cir. 2000) 37, 39, 40

Baravati v. Josephthal, Lyon & Ross, Inc., 834 F. Supp. 1023 (N.D. Ill. 1993) 55

Bearce v. Bass, 34 A. 411 (Me. 1896) 29

Bisbal-Ramos v. City of Mayaguez, 467 F.3d 16 (1st Cir. 2006) 24, 25, 57

Blake v. Pellegrino, 329 F.3d 43 (1st Cir. 2003) 24

Boerner v. Brown & Williamson Tobacco Co., 394 F.3d 594 (8th Cir. 2005) 53

Bose Corp. v. Consumers Union of United States, Inc., 466 U.S. 485 (1984) 21, 24, 46, 51

Broadcort Capital Corp. v. Summa Med. Corp., 972 F.2d 1183 (10th Cir. 1992) 37

Casillas-Diaz v. Palau, 463 F.3d 77 (1st Cir. 2006) 52

Page(s)

Casumpang v. Int'l Longshore & Warehouse Union Local 142, 411 F. Supp. 2d 1210 (D. Haw. 2005)....54

Champagne v. Mid-Maine Med. Ctr., 711 A.2d 842 (Me. 1998)....43

Cicconi v. McGinn, Smith & Co., 808 N.Y.S.2d 604 (App. Div. 2005)....13, 29

Cohen v. Bowdoin, 288 A.2d 106 (Me. 1972)....30

Cole v. Chandler, 752 A.2d 1189 (Me. 2000)....30

Crues v. KFC Corp., 768 F.2d 230 (8th Cir. 1985)....37

Curran v. Richardson, 448 F. Supp. 2d 228 (D. Me. 2006)....47

Cyr v. Adamar Assocs. Ltd. P'ship, 752 A.2d 603 (Me. 2000)....43

Czarnik v. Illumina, Inc., 2004 WL 2757571 (Cal. Ct. App. Dec. 3, 2004)....54

Dalbec v. Gentleman's Companion, Inc., 828 F.2d 921 (2d Cir. 1987)....46

Davis v. Rennie, 264 F.3d 86 (1st Cir. 2001)....55

Deere & Co. v. Int'l Harvester Co., 710 F.2d 1551 (Fed. Cir. 1983)....36

Deluca v. Allied Domecq Quick Serv. Rests., 2006 WL 2713944 (E.D.N.Y. Sept. 22, 2006)....37

Dimino v. New York City Transit Auth., 64 F. Supp. 2d 136 (E.D.N.Y. 1999)....35

Duffy v. Leading Edge Prods., Inc., 44 F.3d 308 (5th Cir. 1995)....33

In re Exxon Valdez, 270 F.3d 1215 (9th Cir. 2001)....57

In re Exxon Valdez, 2006 WL 3755189 (9th Cir. Dec. 22, 2006)....51

Page(s)

FDIC v. Hamilton, 122 F.3d 854 (10th Cir. 1997) 54

Fahnestock & Co. v. Waltman, 935 F.2d 512 (2d Cir. 1991) 55

Faigin v. Kelly, 184 F.3d 67 (1st Cir. 1999) 41

Garrett v. Tandy Corp., 295 F.3d 94 (1st Cir. 2002) 25

Gertz v. Robert Welch, Inc., 418 U.S. 323 (1974) 45

Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132 (6th Cir. 1996) 55

Iacobucci v. Boulter, 193 F.3d 14 (1st Cir. 1999) 53

Johnson v. Hugo's Skateway, 974 F.2d 1408 (4th Cir. 1992) 38

Johnson v. Land O'Lakes, Inc., 181 F.R.D. 388 (N.D. Iowa 1998) 36

Kassel v. Gannett Co., 875 F.2d 935 (1st Cir. 1989) 24

Kraemer v. Franklin & Marshall Coll., 909 F. Supp. 267 (E.D. Pa. 1995) 36

Lane v. Hughes Aircraft Co., 993 P.2d 388 (Cal. 2000) 53

Lavin v. Caleb Brett USA, Inc., 1991 WL 338550 (D. Me. Oct. 28, 1991) 31

Lester v. Powers, 596 A.2d 65 (Me. 1991) 25, 30, 31, 36

Levinsky's Inc. v. Wal-Mart Stores, Inc., 127 F.3d 122 (1st Cir. 1997) 24, 45

Lightfoot v. Union Carbide Corp., 110 F.3d 898 (2d Cir. 1997) 35

Mandel v. Boston Phoenix, Inc., 456 F.3d 198 (1st Cir. 2006) 26, 27

Marcano-Rivera v. Pueblo Int'l, Inc., 232 F.3d 245 (1st Cir. 2000) 24

TABLE OF AUTHORITIES (CONTINUED)

Page(s)

Merriam v. Wanger, 757 A.2d 778 (Me. 2000)..43, 44, 45

Mullin v. Town of Fairhaven, , 284 F.3d 31 (1st Cir. 2002)...................................24

Negron v. Caleb Brett U.S.A., Inc., 212 F.3d 666 (1st Cir. 2000)...........................23

New York Times v. Sullivan, 376 U.S. 254 (1964) 21

Onat v. Penobscot Bay Med. Ctr., 574 A.2d 872 (Me. 1990) 30, 32

Onujiogu v. United States, 817 F.2d 3 (1st Cir. 1987) 41

Rice v. Alley, 791 A.2d 932 (Me. 2002) 32

Rippett v. Bemis, 672 A.2d 82 (Me. 1996) 32

Romano v. U-Haul Int'l, 233 F.3d 655 (1st Cir. 2000) 52

Rowlett v. Anheuser-Busch, Inc., 832 F.2d 194 (1st Cir. 1987) 53, 57

Rubert-Torres v. Hosp. San Pablo, Inc., 205 F.3d 472 (1st Cir. 2000)...................42

S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist., 50 F.3d 476
(7th Cir. 1995) 41

Savoy IBP 8, Ltd. v. Nucentrix Broadband Networks, Inc., 333 B.R. 114
(N.D. Tex. 2005)..41

Schoff v. York County, 761 A.2d 869 (Me. 2000)...25

Smith v. Heritage Salmon, Inc., 180 F. Supp. 2d 208 (D. Me. 2002)......................47

Sparta Surgical Corp. v. Nat'l Ass'n of Sec. Dealers, Inc.,
159 F.3d 1209 (9th Cir. 1998) 13

Staples v. Bangor Hydro-Elec. Co., 629 A.2d 601 (Me. 1993)..................46, 47, 48

Page(s)

State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003)................ *passim*

Towerridge, Inc. v. T.A.O., Inc., 111 F.3d 758 (10th Cir. 1997)............................38

Tuttle v. Raymond, 494 A.2d 1353 (Me. 1985) 45, 47

Uforma/Shelby Bus. Forms, Inc. v. NLRB, 111 F.3d 1284 (6th Cir. 1997)............37

United States v. Barone, 114 F.3d 1284 (1st Cir. 1997)..24

United States v. Hauert, 40 F.3d 197 (7th Cir. 1994)..38

Urico v. Parnell Oil Co., 708 F.2d 852 (1st Cir. 1983)..38

Veilleux v. Nat'l Broad. Co., 206 F.3d 92 (1st Cir. 2000)................................45, 46

Wegerer v. First Commodity Corp., 744 F.2d 719 (10th Cir. 1984) 38

Williams v. ConAgra Poultry Co., 378 F.3d 790 (8th Cir. 2004)............................53

Winchester Packaging, Inc. v. Mobil Chem. Co., 14 F.3d 316
(7th Cir. 1994) 35

Zimmerman v. Direct Fed. Credit Union, 262 F.3d 70
(1st Cir. 2001)..50, 56

STATUTES AND RULES

15 U.S.C. § 78s 13

28 U.S.C. § 1291 1

28 U.S.C. § 1331 1

28 U.S.C. § 1332 1

29 U.S.C. § 1132(e)(1)..1

TABLE OF AUTHORITIES (CONTINUED)

Page(s)

Fed. R. Evid. 403 .... *passim*

Fed. R. Evid. 408 .... *passim*

MISCELLANEOUS

Anne H. Wright, *Form U-5 Defamation,* 52 WASH. & LEE L. REV. 1299 (1995)..30, 56

BLACK'S LAW DICTIONARY (7th ed. 1999) 36

Isaac Hunt, Commissioner, SEC, Remarks at 1997 National Society of Compliance Professionals National Membership Meeting (Oct. 9, 1997), *available at* http://www.sec.gov/news/speech/speecharchive/1997/spch180.txt..29

NASD By-Laws, art. V, § 3(a) 12, 39

RESTATEMENT (SECOND) OF TORTS (1965)...43

Robert D. Sack, SACK ON DEFAMATION (3d ed. 1999)...44

JURISDICTIONAL STATEMENT

The district court had jurisdiction under 28 U.S.C. §§ 1331, 1332, and 1367 and 29 U.S.C. § 1132(e)(1). The district court entered final judgment on June 28, 2006. A23. Merrill Lynch's timely motion for judgment as a matter of law ("JMOL") or, in the alternative, for a new trial was filed on July 13, 2006, and denied on August 29, 2006. A15; A17. Merrill Lynch filed a timely notice of appeal on September 26, 2006. A17. This Court has jurisdiction under 28 U.S.C. § 1291.

ISSUES PRESENTED

After fully investigating complaints made against her by one of her clients, Merrill Lynch fired Deborah Galarneau in January 2004. Because Galarneau was a registered securities broker, Merrill Lynch was required to file a Form U-5 Uniform Termination Notice setting forth the reasons for Galarneau's termination. As a courtesy, Merrill Lynch afforded Galarneau an opportunity to comment on a draft of the U-5. The draft stated that Merrill Lynch terminated Galarneau for, *inter alia*, "inappropriate bond trading in one client's account." In response, Galarneau "request[ed]" that the U-5 state in relevant part that she "was terminated because of bond related trades in one client account that the Firm considered to be lawful but not appropriate." She further requested that the U-5 include her assertion that "she was wrongfully terminated for bond related trades that were lawful." Viewing Galarneau's proposed characterization of the reasons for her termination as func-

tionally indistinguishable from its characterization, Merrill Lynch retained the description from the original draft, but, accommodating Galarneau's request, added that "Ms. Galarneau disagrees with the Firm's conclusions." Although the operative language in the U-5 was thus substantially similar to the language Galarneau had "request[ed]," Galarneau brought suit, claiming, *inter alia*, that the U-5 was defamatory. Prior to trial, the district court excluded the correspondence between the parties relating to the draft U-5. Unaware that Galarneau had essentially ratified the language in the U-5, the jury found Merrill Lynch liable for defamation, and awarded Galarneau $850,000 in compensatory damages and $2,100,000 in punitive damages. The issues presented are:

1. Whether Galarneau adduced sufficient evidence that Merrill Lynch's statement, which was conditionally privileged under Maine law, was both false and made with malice.

2. Whether the district court erred in excluding evidence that the parties had negotiated the language that Galarneau thereafter alleged to be defamatory.

3. Whether Galarneau adduced sufficient evidence of causation to support the compensatory award.

4. Whether the evidence satisfied the stringent standards for imposition of punitive damages.

5. Whether the punitive award is unconstitutionally excessive.

STATEMENT OF THE CASE

This case arises from Merrill Lynch's termination of Deborah Galarneau, and Merrill Lynch's subsequent characterization of the reasons for Galarneau's termination in a mandatory regulatory filing. After those events occurred, Galarneau sued, asserting *inter alia* claims for sex discrimination, breach of contract, and defamation. The jury rejected Galarneau's discrimination and contract claims, but found in her favor on the defamation claim, awarding her both compensatory and punitive damages. After the verdict was returned, Merrill Lynch moved for JMOL or, in the alternative, for a new trial. The district court denied that motion without explanation.

STATEMENT OF FACTS

1. Merrill Lynch warns Galarneau not to engage in active bond trading.

Galarneau was a registered financial advisor in Merrill Lynch's Portland, Maine, office.[1] On at least two occasions prior to her dismissal Galarneau's bond trading had been the object of concern. In 1998, Galarneau was summoned to a meeting with her office supervisors "to discuss two client complaints, and her trading strategy in regards to bond swaps." JA489. Then, in 2000, her supervisors

[1] A "registered representative" is someone who is, by virtue of his or her licensing, entered in the Central Registration Depository, a national database of securities brokers.

specifically warned her not to engage in active bond trading. Noting that "trading in bonds could be very expensive for the client" and that "bond trading if it was going to be done, should be done in a managed fund or a mutual fund," Galarneau's supervisors told her that her strategy of actively trading bonds was "inappropriate." JA159–JA161.[2] When warned that active bond trading was inappropriate, Galarneau promised that she "would not do that anymore." JA161. Unfortunately, Galarneau did not keep her word.

2. A customer complaint alerts Merrill Lynch that Galarneau had again engaged in inappropriate bond trading.

In 2003, one of Galarneau's clients, Amy Ford, lodged a complaint against Galarneau. JA493. Ford was a spiritual healer who lived off an inheritance that she had received from an uncle. JA3. As Ford explained to Galarneau, Ford "was relying on her investments for her income." JA42. Indeed, Ford entrusted Galarneau with the money that Ford depended upon "to fulfill her needs for the rest of her life." JA338.

In Galarneau's view, Ford's portfolio was overly concentrated in stocks. Consequently, Galarneau formulated a plan, "the major objective" of which purportedly was to "rebalance" Ford's portfolio by selling stock and using the pro-

[2] Mutual funds can profitably engage in bond trading because they pay a substantially lower commission than retail customers. JA321–JA323.

ceeds to acquire fixed-income investments such as bonds. JA45.[3] Because the stock Ford owned had appreciated over time, its sale would result in taxable capital gains. JA46. According to Galarneau, under the plan she devised for Ford, "tax advantage bond swap[s]" would be used "to counteract the gains" that Ford would make on the sale of stock. JA47.

A tax-motivated bond swap involves the sale of one depreciated bond, and the immediate purchase of another with the proceeds of that sale. A bond is an interest bearing security: In exchange for loaning a certain amount of money for a certain period of time, the owner of the bond receives periodic payments of a predetermined amount for the life of the bond and then, when the bond reaches maturity, is repaid the amount originally loaned. JA147–JA149; JA342–JA344. Every bond has a fixed face value equal to the amount for which it will be redeemed at maturity. But bond prices in the secondary market vary as interest rates change and as investors reassess risk. Thus, a $10,000 bond that an investor purchased at face value may now trade for only $9,000. In that case, the investor has an unrealized loss of $1,000. In a bond swap, the investor sells the depreciated bond, realizes the $1,000 loss (which can be used to offset gains for tax purposes), and uses

[3] Because they yield predetermined dividends, preferred stocks are another form of fixed-income investment. JA155. As Galarneau acknowledges, they are "pretty much" the same as bonds. JA162. At trial, the term 'bonds' was often used to refer to both bonds and preferred stocks.

the $9,000 proceeds to purchase another, roughly equivalent $10,000 bond that has similarly depreciated in value. The newly purchased bond will yield the same periodic payments, and when it matures the investor will receive his or her initial $10,000 investment back. As Galarneau stated at trial, with a bond swap "the idea is that when you purchase the bond, eventually it will mature, and you will get the face value of that bond back again, and in the meantime, you receive a regular income, which is usually fixed." JA48.

A bond swap has a lengthy time horizon. As Galarneau herself explained, "*in the long run*, that bond matures, and you get the face value back again." JA48 (emphasis added). As noted by Galarneau's hired expert, a bond swap results in no actual (as opposed to tax) loss *if the bond that is purchased is held to maturity*. JA351–JA352. However, if the bond purchased in a swap is quickly sold rather than held to maturity, actual losses may result, both because the value of the purchased bond may have declined in the secondary market and because of the high commissions associated with retail bond transactions.[4]

[4] The commission on a bond is built into the purchase price. Thus, a bond bought in the secondary market is, immediately after purchase, worth less than its purchase price. For example, if there is a 2% commission on a bond bought for $1,000, that bond is actually worth only $980 immediately after its purchase. JA140–JA142.

Despite Galarneau's promise to Merrill Lynch that she would not again engage in active bond trading, Ford accused Galarneau of doing exactly that. In a letter sent to Galarneau and to the State of Maine Office of Securities, Ford complained that (among other things) Galarneau had engaged in "an excessive amount of trading in the account." JA493. Ford noted that "[m]any of my fixed-income holdings have been held less than two months." *Id.* With reference to $1.35 million of bonds that Galarneau had sold, Ford observed:

> The average time to maturity for those bonds was 21 years. The average time I held the bonds was 145 days.

Id. After noting that longer-term bonds typically carry higher commissions than short-term bonds, Ford pointed out that "many of the short holding period sales in my account have involved long and medium term bonds." *Id.* The turnover in her account, Ford complained, "is much higher than the experts I have worked with consider reasonable." JA494. While acknowledging the need to take tax considerations into account, Ford noted that "the goal should be taking losses that exist, not creating them." *Id.*

3. Merrill Lynch's internal investigation confirms that Galarneau engaged in inappropriate bond trading.

Ford's complaint triggered an investigation by the State of Maine and an internal investigation by Merrill Lynch. During the course of the internal investigation, Merrill Lynch's Office of General Counsel ("OGC"), among other things, re-

viewed the trading activity in Ford's account (JA805–JA823), sought written explanations from Galarneau (JA615–JA680), interviewed Galarneau twice (JA410; JA447–JA448), reviewed Galarneau's personnel file (JA488; JA489–JA490), and interviewed several of Galarneau's other clients (JA513).[5]

As part of its investigation, the OGC asked Bates Private Capital, an outside firm, to conduct a detailed analysis of the Ford account. JA398. The Bates report presented the trading in the Ford account on a security-by-security basis. It showed when a given security was purchased, the purchase price, when the security was sold, and the sale price. Moreover, because the report was organized alphabetically, it also clearly showed whether a given security was subsequently repurchased, and if so, at what price, and whether the repurchased security was sold, and if so, at what price. Thus, for each fixed-income security that had been traded in the Ford account, the Bates report revealed how long the security had been held, whether it was sold at a profit or loss, whether it was subsequently repurchased and resold, and, if so, whether at a profit or loss.[6] JA805–JA823; JA399–JA400.

---

[5] While the internal investigation relating to the Ford account was still pending, a separate complaint was lodged against Galarneau by client Brittany Morin. Upon investigation, the OGC concluded that Morin's complaint was unfounded. JA449.

[6] Thus, unlike Armor alerts—monthly alerts that are triggered by certain activity in an account (*see* JA206–JA207)—the Bates report provided a comprehensive overview of the trading activity over the life of the Ford account. Armor

The Bates report was devastating. According to Kathleen Durning, who had requested its preparation, the Bates report

> showed a lot of trading. It showed some securities held just for a couple of weeks. It showed that—it's one thing to capture a tax loss, but it showed that the activity was causing the losses.

JA400. The misconduct revealed by the Bates report was so extreme that Durning "had not seen anything like this" in the more than 100 customer complaints she had investigated. JA401.

Galarneau's bond trading cost Ford dearly. Ford lost more than $90,000 as a result of Galarneau's trading. JA178; JA403. The trades that generated those losses cost Ford thousands more in commissions. JA403.[7] Moreover, because many of the trades were done on margin, Ford was forced to pay between $25,000 and $30,000 in interest. JA403–JA404.

---

alerts, by contrast, provide "just a snapshot of the account at a certain time." JA214.

[7] Overall, Ford paid approximately $90,000 in commissions. Had her account been managed on a flat-fee basis using the Merrill Lynch Unlimited Advantage ("MLUA") program, Ford would have paid "dramatically" less in commissions—about $4,500 rather than $90,000. JA318–JA320. Galarneau claimed that she and her husband, with whom she worked, offered Ford the MLUA program. But when their supervisor requested proof, "[t]hey were not able to provide any documentation to suggest they had offered an MLUA to Ms. Ford at any point in time." JA324.

Given what its internal investigation revealed, Merrill Lynch concluded that it had no hope of successfully defending itself in the arbitration that Ford threatened to bring as a result of Galarneau's trading. JA506. When asked why Merrill Lynch reached that conclusion, Durning testified:

> Well, the activity in the account, when you are looking at the frequency of trading, what the client is purchasing, the use of margin, didn't really make sense so we weren't really going to be able to defend that in arbitration.

JA402. Having concluded that Galarneau's trading was indefensible, Merrill Lynch settled Ford's complaint for $100,000. JA406–JA407.

As for Galarneau, Merrill Lynch concluded, on the basis of its internal investigation, that she had engaged in inappropriate bond trading. Richard Heller, the Administrative Manager of the Portland office, found that Galarneau's trading in the Ford account "was excessively inappropriate for the bonds." JA277. Craig Colbath, the branch manager—who ultimately concluded that Galarneau "performed inappropriate trading in the Amy Ford account" (JA326)—was struck by "the enormity of the amounts of transactions and trading done in these long-term bonds in such a short-term ma[nn]er." JA324. Durning, who had day-to-day responsibility for conducting the internal investigation, concluded that the level of bond trading in the Ford account was "[h]ighly excessive" and that "[i]t didn't make a lot of sense." JA406; JA409. Durning's OGC colleague, Scott Gilbert, found that Galarneau

> had engaged in pretty egregious misconduct. She had traded Ms. Ford's account, specifically the bond trades within the account in a manner that I thought was excessive and unsuitable for Ms. Ford. I thought on top of that, she had done so despite the fact that her managers had previously talked to her and warned her about that type of trading, specifically these bond trades with respect, I believe, to other clients. That exacerbated the situation.

JA448.

As a further result of its internal investigation, Merrill Lynch concluded that Galarneau had, in addition to the inappropriate bond trading, also engaged in other misconduct. In particular, the firm found—and Galarneau admitted—that she had exercised "time and price discretion" in three client accounts. JA395; JA411; JA449; JA471.[8]

4. Galarneau is terminated for inappropriate bond trading and for utilizing time and price discretion.

After completing the internal investigation, Durning concluded that "Galarneau should be terminated." JA393. "The primary reason," according to Durning, "was the trading in the Amy Ford account," which was characterized by

[8] Time and price discretion, a violation of company policy, occurs when a client authorizes a particular trade (for example, buying X shares in Y company) but the broker, rather than executing the trade immediately, instead chooses when and at what price to make the trade. JA307.

an "excessive number of trades" and "the use of margins to purchase fixed income investments." JA394.

Durning was not alone in her judgment. Indeed, all four members of the OGC staff involved in the investigation agreed that "the trading was excessive, unsuitable, [and] possibly unauthorized." JA414. The four recommended that Galarneau be terminated in part because she "had been told about this activity before" and "had been specifically warned" but nonetheless "continued to do it." JA416. The recommendation that Galarneau be terminated for inappropriate bond trading (and for utilizing time and price discretion) was unanimous. Id.

Having reached consensus as to the proper course of action, the OGC staff conveyed its recommendation to the Portland regional management in a conference call with Heller, Colbath, and senior manager Edward Hocking. Hocking accepted the OGC's recommendation. JA417. Accordingly, on January 6, 2004, Galarneau was terminated.

5. Merrill Lynch complies with its regulatory obligation to report the reasons for Galarneau's termination.

Because Galarneau was a registered representative, Merrill Lynch was required, under art. V, § 3(a) of the NASD By-Laws, to report the reasons for her termination in a Form U-5 Uniform Termination Notice within 30 days of the ter-

mination.[9] As a courtesy, Merrill Lynch (by letter dated January 29, 2004) afforded Galarneau an opportunity to comment on a draft of the U-5. According to that draft:

> Ms. Galarneau was terminated after the Firm concluded that she had (i) engaged in inappropriate bond trading in one client's account and (ii) utilized time and price discretion in the accounts of three clients.

A40. In response, Galarneau's attorney sent a letter on February 5, 2004, "request[ing] that the U-5 state":

> Ms. Galarneau was terminated because of bond related trades in one client account that the Firm considered to be lawful but not appropriate and because of isolated violations of an internal policy of the Firm at the specific request of three clients.

A42. Galarneau also expressed her "wish[]" that the U-5 additionally state:

> Ms. Galarneau claims that she was wrongfully terminated for bond related trades that were lawful, benefited the client, and were in an account whose activity was reviewed and approved by the Firm on five separate occasions and for isolated violations of an internal policy of the Firm at the specific request of three clients.

---

[9] NASD is a self-regulatory organization whose rules are subject to SEC approval. *See* 15 U.S.C. § 78s. As "the primary regulatory body for the broker-dealer industry," NASD "supervises the conduct of its members under the general aegis of the SEC." *Sparta Surgical Corp. v. Nat'l Ass'n of Sec. Dealers, Inc.,* 159 F.3d 1209, 1210 (9th Cir. 1998). "The mandatory filing" of the U-5 "is required in connection with a broad and complex regulatory scheme which is overseen by the SEC." *Cicconi v. McGinn, Smith & Co.*, 808 N.Y.S.2d 604, 607 (App. Div. 2005).

Id. Construing Galarneau's first suggestion as non-substantive, Merrill Lynch retained its original description of its reasons for terminating her. But in response to her "wish[]" that her point of view to be included, Merrill Lynch added:

> Ms. Galarneau disagrees with the Firm's conclusions and further maintains that the clients as to whom time and price discretion was exercised requested that she do so.

JA595.

6. Proceedings below.

Galarneau brought an eight-count complaint alleging sex discrimination, breach of contract, breach of fiduciary duty, defamation, tortious interference with economic relations, and violations of ERISA and the Equal Pay Act. Galarneau subsequently withdrew the breach-of-fiduciary-duty and Equal Pay Act claims. Dkt. No. 33, at 20 n.16. After the district court denied Merrill Lynch summary judgment, the remaining claims proceeded to trial.

(a) The district court excludes all evidence of Galarneau's request that the U-5 state that she had been terminated for bond trading that was "not appropriate."

Prior to trial, Galarneau filed a motion *in limine* to exclude all evidence that she herself had requested that the U-5 state that she had been terminated for bond trading that Merrill Lynch deemed "not appropriate." Dkt. No. 62. Galarneau claimed that evidence of her proposed language was subject to exclusion under Fed. R. Evid. 408 "because it constitutes an offer of compromise and/or a commu-

nication made during settlement negotiations," or, in the alternative, under Fed. R. Evid. 403 because it had "minimal relevance compared to its unfair prejudice." Dkt. No. 62, at 3.[10] At a pretrial hearing, the district court, invoking Rule 408 alone, granted Galarneau's motion subject to revisiting the issue at trial. A25–A26. Immediately before opening arguments, the district court reaffirmed its prior ruling:

> I'm not going to let it in. I'm not changing my previous ruling. I think under 408, 403, and in my discretion in this matter, I think it opens doors that might well require counsel to testify. I think they are settlement discussions. Merrill Lynch is free to point to the disclaimer language and argue that language to the jury. It may be a good argument in terms of malice, but I'm not going to allow in the discussions between counsel, whether orally or in writing.[11]

A36.

(b) The evidence introduced at trial confirms that Galarneau was fired for inappropriate bond trading.

The evidence introduced at trial confirmed what Merrill Lynch reported in the U-5, namely that Galarneau was fired for inappropriate bond trading (and for

---

[10] Galarneau never attempted to articulate how she would be unfairly prejudiced if evidence of her proposed language were admitted. Her fleeting invocation of Rule 403 was clearly a makeweight; she mentioned the rule neither in her reply brief nor at oral argument.

[11] "Disclaimer language" is an apparent reference to the final sentence of the U-5, which notes that "Ms. Galarneau disagrees with the Firm's conclusions."

exercising time and price discretion).[12] In addition to the evidence discussed above (at pages 7–11) both Galarneau and her hired expert, while denying the conclusion that necessarily followed, conceded underlying facts demonstrating the inappropriateness of Galarneau's bond trading.[13]

Galarneau admitted that her trading in the Ford account was "very active." JA138. She also conceded that, although previously warned about such conduct, "active trading and * * * bond swapping is precisely what [she] did in Amy Ford's account." JA161. In addition to acknowledging generally that the "large majority of bonds were bought and sold in short time periods" (JA144), Galarneau specifically admitted that of the 167 bonds (or preferred stocks (*see* n.3 *supra*)) she bought, 123 were held less than six months, 148 were held less than one year, and only 3 were held more than two years (JA163–JA164).[14] Having further conceded that the Bates report shows "repeated instances of buying and selling bonds and

---

[12] Galarneau concedes that she exercised time and price discretion. JA471.

[13] Although the expert opined that Galarneau's trading was "suitable" to Ford's needs and objectives (JA338), he did not calculate what Ford paid in commissions, and did not determine what Ford's account would have looked like had the bonds initially bought to balance the account been held rather than actively traded (JA360–JA361).

[14] Galarneau also did not dispute Ford's allegation that the bonds Galarneau bought had maturity dates averaging 21 years but were sold on average after just 145 days. JA150. Nor did she dispute Ford's allegation that between February 2001 and March 2003 Galarneau bought and resold 58 medium- and long-term bonds, 36 of which were sold within 90 days of purchase. JA154–JA155.

preferred stocks over a short period of time with losses 95 percent of the time" (JA181), Galarneau also acknowledged that "one might look at" the Bates report "and draw the conclusion that we had done something wrong." JA468.[15]

Galarneau's own expert, Gerald Guild, made similarly damning concessions. Guild admitted, for example, that, although Galarneau claimed that a major goal of her trading was to "rebalance" Ford's account, the percentage of fixed-income assets in the account remained essentially unchanged over the relevant period, increasing only one percentage point from 42% at the end of 2000 to 43% as of May 30, 2003. JA353; JA830–JA845; JA862–JA876. Similarly, after observing that most of the bonds in Ford's account were long-term bonds that "Ford could hold * * * to maturity" because "her needs were very long-term," Guild admitted that "many of these long-term bonds were not held for a very long period of time." JA357; JA358. In fact, Guild admitted, although Ford's account held only $300,000 to $460,000 in fixed-income securities at any given point between 2000 and 2003, during that same period Galarneau sold, in the aggregate, nearly $3.2 million of fixed-income securities—or 8 to 10 times the total amount of fixed-

[15] Galarneau admitted, too, that "trading actively in bonds, because of that markup and spread, can be very expensive." JA159–JA160. Furthermore, after acknowledging that the commission on long-term bonds is higher than on short-term bonds, Galarneau admitted that she generally bought intermediate- to long-term bonds for the Ford account. JA153–JA154.

income securities in the Ford account at any given moment. JA354; JA358; JA808; JA824–JA829; JA830–JA845; JA846–JA861; JA862–JA876. Given those facts, Guild was forced to concede that there was "a significant amount of trading in * * * Amy Ford's account given her investment objectives and her situation." JA359–JA360.

That "significant amount of trading," Guild acknowledged, included a series of short-term transactions that cost Ford money and left her without any bonds. In particular, Guild acknowledged that Galarneau bought tax-free Maine HEFRA bonds on March 9, 2001, and swapped those bonds on March 29, 2001, for (taxable) Chrysler bonds, which she then swapped on April 14, 2001, for MCI bonds, which she in turn swapped on May 24, 2001, for WorldCom bonds, which she then sold on June 29, 2001, splitting the proceeds between the Oppenheimer Security Fund and US West bonds, before selling the Oppenheimer shares for cash on October 19, 2001, and selling the US West bonds on November 30, 2001, using the proceeds to buy shares in the Aberdeen Asia fund. Guild conceded that Galarneau's "numerous" trades—each of which was done at a loss—"resulted in a series of losses to [Ford], and also resulted in her not having any bonds in her portfolio as a result of those transactions." JA362–JA376 (relying on JA615–JA680 and JA805–JA823). Guild further conceded that on May 10, 2001—*i.e.*, in the midst of the transactions that began with the sale of Maine HEFRA bonds—

Galarneau repurchased Maine HEFRA bonds only to sell them again on December 14, 2001. Guild admitted that had Ford simply held the original Maine HEFRA bonds she would have earned tax-free income throughout the period and "she would not have incurred these losses that we have seen from these various transactions." JA377–JA378.

(c) The jury verdict and post-trial motion.

At the close of plaintiff's evidence, Merrill Lynch moved for JMOL on all counts. Dkt. No. 143. The district court granted the motion with respect to Galarneau's tortious interference claim, but otherwise denied it. JA386–JA387.[16] At the close of all evidence, the district court denied Merrill Lynch's renewed motion for JMOL. JA469–JA470. Accordingly, Galarneau's claims for sex discrimination, breach of contract, and defamation were sent to the jury (and her ERISA claim was submitted to the court). The jury rejected Galarneau's discrimination and contract claims, and the court rejected her ERISA claim (JA487), but the jury found in Galarneau's favor on the defamation claim, awarding Galarneau $850,000

[16] In denying the motion, the district court linked the fate of Galarneau's defamation claim to that of her discrimination claim, observing that the former would "rise and fall" with the latter because "[i]f there is not enough evidence to show that they intentionally fired her because of her sex, then * * * [the defamation claim] disappear[s]." JA383–JA385.

in compensatory damages (of which $775,000 were for lost wages) and $2,100,000 in punitive damages. A20; A22.

Merrill Lynch thereafter timely moved for JMOL or, in the alternative, for a new trial. Dkt. No. 159. Despite its earlier statement that the defamation claim would "rise and fall" with the discrimination claim (*see* n.16 *supra*), the district court summarily denied that motion.

SUMMARY OF ARGUMENT

Truth used to be an absolute defense. Not anymore. Despite the demonstrable—and demonstrated—truth of the statement at issue, the jury held Merrill Lynch liable for defamation. It is a remarkable result, particularly in light of the fact that Galarneau herself had proposed language substantially similar to that which she now claims is defamatory. The significance of the verdict extends well beyond this one case. If the multimillion-dollar judgment is allowed to stand, every securities firm in the country, fearful of suffering the same fate as Merrill Lynch, will hesitate before providing regulators a full and frank explanation of why a rogue broker was terminated. Deborah Galarneau's windfall is every investor's nightmare.

The statement at the heart of this defamation case—contained in an obligatory report to securities regulators—is conditionally privileged. Galarneau therefore had to prove that the statement was not only false, but made with malice (*i.e.*,

with ill will or with knowledge of or reckless disregard for its falsity). Moreover, when reviewing the sufficiency of the evidence, this Court, rather than deferring to the jury's determination, has "an obligation to 'make an independent examination of the whole record' in order to make sure that 'the judgment does not constitute a forbidden intrusion on the field of free expression.'" *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 499 (1984) (quoting *New York Times v. Sullivan*, 376 U.S. 254, 284–86 (1964)).

The defamation verdict does not pass muster. Rather than prove the falsity of Merrill Lynch's statement, the evidence introduced at trial demonstrated that—as stated in the U-5—Galarneau was terminated after Merrill Lynch concluded that she had engaged in inappropriate bond trading. Moreover, even if the statement were false, there was no evidence, let alone sufficient evidence, to prove that the statement was made with malice. Merrill Lynch is therefore entitled to JMOL.

At minimum, Merrill Lynch is entitled to a new trial because the district court, invoking Rules 403 and 408 of the Federal Rules of Evidence, erroneously excluded highly probative evidence relating to the drafting of the U-5. That evidence—letters exchanged by the parties prior to finalization of the U-5—shows among other things that Merrill Lynch had provided Galarneau with a draft and that in response Galarneau herself had proposed using substantially similar language to describe the reasons for her termination. The letters' exclusion under

Rule 408 was erroneous because they were not settlement offers, were not written during settlement discussions, and were in any event offered for purposes other than those barred by the rule. Their exclusion under Rule 403 was erroneous because *no* unfair prejudice would have resulted from their admission, much less unfair prejudice that substantially outweighed the probative value of this evidence. Because the letters eviscerate any suggestion that Merrill Lynch acted with malice, their improper exclusion constitutes reversible error.

The compensatory award of $850,000 must, at minimum, be reduced to $75,000 (*i.e.*, the amount awarded for non-economic harm) because Galarneau failed to prove that the purportedly defamatory statement was the proximate cause of her economic losses. She presented no competent evidence that even a single employer had refused to hire her as a result of the U-5, and she failed to rebut evidence of other causes for her unemployment. The compensatory award was, therefore, based on impermissible speculation at best.

Merrill Lynch is in all events entitled to JMOL with respect to punitive damages. To obtain punitive damages, Galarneau was required to prove by clear and convincing evidence both that Merrill Lynch acted out of ill will or in an outrageous manner and that it had knowledge of or recklessly disregarded the (purported) falsity of its statement. Even if the evidence at trial was sufficient to sustain such findings under a preponderance standard (which we dispute), it was

manifestly insufficient to sustain such findings under the heightened 'clear and convincing' standard. Accordingly, the imposition of punitive liability cannot stand.

Moreover, even if some amount of punitive damages were permissible, the $2,100,000 award is unconstitutionally excessive under the circumstances of this case. The award does not withstand scrutiny under the "[e]xacting appellate review" mandated by *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 418 (2003): Merrill Lynch's conduct was not reprehensible; Galarneau received substantial compensatory damages; and the amount awarded is disproportionate when compared to comparable cases. Furthermore, because it would deter firms from providing complete and frank information to securities regulators, a large punitive award would unduly chill socially useful speech. The punitive award should therefore be reduced to, at most, a nominal sum.

STANDARD OF REVIEW

In an appeal from a district court's denial of a motion for JMOL, this Court "review[s] questions of law de novo" (*Negron v. Caleb Brett U.S.A., Inc.*, 212 F.3d 666, 668 (1st Cir. 2000)), and "[i]n assessing the sufficiency of the evidence to support a jury verdict," typically "ask[s] whether, viewing the evidence in the light most favorable to the verdict, a rational jury could have found in favor of the party

that prevailed" (*Bisbal-Ramos v. City of Mayaguez*, 467 F.3d 16, 22 (1st Cir. 2006)).

But when, as here, First Amendment concerns are implicated, "the deference traditionally shown by courts toward factfinders' determinations is muted." *Levinsky's Inc. v. Wal-Mart Stores, Inc.*, 127 F.3d 122, 127 (1st Cir. 1997). In such cases, "an appellate court has an obligation to 'make an independent examination of the whole record' in order to make sure that 'the judgment does not constitute a forbidden intrusion on the field of free expression.'" *Bose*, 466 U.S. at 499; *accord Mullin v. Town of Fairhaven*, 284 F.3d 31, 37 (1st Cir. 2002). "As a practical matter, this [independent review] requirement means that federal courts engage in de novo review when mulling defamation issues that are tinged with constitutional implications." *Levinsky's,* 127 F.3d at 127; *accord Kassel v. Gannett Co*., 875 F.2d 935, 937 (1st Cir. 1989).

"[T]he district court's construction of evidentiary rules is a question of law which [this Court] review[s] de novo" (*United States v. Barone*, 114 F.3d 1284, 1296 (1st Cir. 1997) (emphasis omitted)), while the district court's application of the rules to particular facts is reviewed for abuse of discretion (*see Blake v. Pellegrino*, 329 F.3d 43, 46 (1st Cir. 2003)).

Whether sufficient evidence exists to support a punitive award is a question of law that is reviewed de novo (*see Marcano-Rivera v. Pueblo Int'l, Inc.*, 232 F.3d

245, 254 (1st Cir. 2000)), as is the question whether a punitive award is unconstitutionally excessive (*see Bisbal-Ramos*, 467 F.3d at 27).

ARGUMENT

I. THE EVIDENCE WAS INSUFFICIENT TO SUPPORT PLAINTIFF'S DEFAMATION CLAIM.

To establish defamation, Galarneau was required to prove that Merrill Lynch made a false statement and did so with malice. Galarneau proved neither prong, let alone both. Under any standard, and certainly under the exacting review applicable to this case, Merrill Lynch is entitled to JMOL.

A. The Defamation Verdict Cannot Stand Because The U-5 Was Truthful.

"To prove defamation," the plaintiff "must establish that * * * [the defendant] made a *false* and defamatory statement." *Schoff v. York County*, 761 A.2d 869, 871 (Me. 2000) (emphasis added); *see also Lester v. Powers*, 596 A.2d 65, 69 (Me. 1991) ("The statement must be false."). Accordingly, "truth is an absolute defense to a charge of defamation." *Garrett v. Tandy Corp.*, 295 F.3d 94, 106 (1st Cir. 2002) (applying Maine law).

Here, Merrill Lynch stated that "Ms. Galarneau was terminated after the Firm concluded that she had (i) engaged in inappropriate bond trading in one client's account and (ii) utilized time and price discretion in the accounts of three cli-

ents." JA595. That is a true statement. Galarneau's defamation claim therefore fails as a matter of law.

Galarneau admitted utilizing time and price discretion in three clients' accounts. JA471. Thus, the only possible basis for her defamation claim is the statement that she "engaged in inappropriate bond trading in one client's account." Because that is a demonstrably true statement and no rational jury could have concluded otherwise, the defamation verdict is unsustainable, whether this Court conducts an "independent review of the evidence" as is required in defamation cases (*Mandel v. Boston Phoenix, Inc.*, 456 F.3d 198, 208 (1st Cir. 2006)), or applies the less searching standard that governs other cases.

The evidence at trial demonstrates that, as stated in the U-5, Galarneau engaged in inappropriate bond trading.[17] Despite having been previously warned that active bond trading was "inappropriate," and despite having agreed that she "would not do that anymore," Galarneau concedes that "active trading and * * * bond swapping is precisely what [she] did in Amy Ford's account." JA161; *see also* JA138 (admitting that her trading in the Ford account was "very active"). Thus, although most of the bonds in Ford's account were long-term bonds that "Ford could hold * * * to maturity" because "her needs were very long-term"

---

[17] *See* pages 7–11 and 15–19 *supra*.

(JA357), the "large majority of bonds were bought and sold in short time periods" (JA144). Rather than capturing unrealized losses that already existed, Galarneau's trading "caus[ed] the losses." JA400. As a result of that trading, which was characterized by "repeated instances of buying and selling bonds and preferred stocks over a short period of time with losses 95 percent of the time" (JA181), Ford incurred losses exceeding $90,000 and, in addition, paid tens of thousands of dollars in commissions and interest (JA403–JA404). In light of this uncontroverted evidence—which shows that Galarneau's "[h]ighly excessive" bond trading was not merely inappropriate, but "egregious misconduct" (JA406; JA448)—Galarneau plainly failed to satisfy her "constitutionally imposed burden of showing the falsity" of the U-5 statement (*Mandel*, 456 F.3d at 208).[18]

Accordingly, because Galarneau had in fact "engaged in inappropriate bond trading," the U-5 was not false, and the defamation verdict cannot stand.[19]

---

[18] Because "misconduct" was cause for forfeiture under the incentive-compensation agreements (JA696; JA714) and Galarneau was denied incentive compensation for "sales practice (bond trading) misconduct" (JA600; JA602), Galarneau had a valid breach-of-contract claim if but only if she could prove that she had not engaged in such misconduct. Thus, in rejecting Galarneau's contract claim (A21), the jury implicitly found that Galarneau had committed bond trading misconduct, a finding that raises serious doubt as to the sufficiency of the evidence with respect to Galarneau's defamation claim.

[19] In opposing Merrill Lynch's Rule 50(b) motion, Galarneau relied primarily on four pieces of evidence to support her contention that the U-5 contained a false statement. In particular, Galarneau pointed to evidence that (i) Guild, her hired

B. The Defamation Verdict Cannot Stand Because Merrill Lynch Did Not Act With Malice.

Even if the U-5 were false, Merrill Lynch would still be entitled to JMOL because Galarneau adduced no evidence, let alone sufficient evidence, to prove that Merrill Lynch acted with malice.

1. The U-5 was conditionally privileged.

There is no dispute that under Maine law, which applies here, the U-5 was conditionally privileged. A30. The purpose of the conditional privilege is to en-

---

expert, considered the trading in Ford's account to be appropriate and not excessive (JA361; JA382); (ii) prior to Ford's complaint, the Portland branch management had reviewed and purportedly "approved" Galarneau's trading after activity in Ford's account triggered Armor alerts (JA787–JA798); (iii) Hocking, the senior regional manager, never specifically told Galarneau that she was being terminated for inappropriate bond trading (JA119–JA120; JA267–JA270); and (iv) in a letter to Maine regulators Merrill Lynch described the trading in Ford's account as "somewhat active" (JA559). Galarneau also argued that the U-5 was defamatory because it purportedly accused her of having churned Ford's account. *See* Dkt. 164, at 4. The evidence relied upon by Galarneau, however, is not sufficient to support a finding of falsity: Guild's conclusory opinion is belied by Galarneau's frequent short-term trading in long-term bonds (*see* pages 7–10, 16–17 *supra*); the purported "approval" of Galarneau's trading was based largely on Galarneau's own reports and was given before the Bates report revealed the inappropriateness of her trading (Tr. 866–67); although Hocking did not use the term "inappropriate trading," he did tell Galarneau that she was terminated for exercising "very poor judgment in the Ford account by pursuing the complicated strategy" after having been "warned" of "similar conduct in [the] past" (JA120; JA549); and Merrill Lynch's letter to Maine regulators specifically noted that Galarneau had been terminated, *inter alia*, as a result of "management's ongoing concerns regarding [t]he activity in Ms. Ford's account" (JA560). Moreover, contrary to Galarneau's contention, the U-5 did not accuse her of churning. JA595.

courage communications made for "the common protection and welfare of society." *Bearce v. Bass*, 34 A. 411, 413 (Me. 1896).

The U-5 plainly serves that important public purpose. As an SEC commissioner once explained:

> The importance of candor on the Form can't be understated [sic]. It is a critical warning mechanism, alerting prospective (hiring) firms. Accurate reports help rid the industry of problem sales reps, or at least ensure that firms have adequate notice of the potential risks and accompanying supervisory responsibilities if they hire those with suspect histories.

Isaac Hunt, Commissioner, SEC, Remarks at 1997 National Society of Compliance Professionals National Membership Meeting (Oct. 9, 1997), *available at* http://www.sec.gov/news/speech/speecharchive/1997/spch180.txt.[20] A conditional privilege for U-5 statements is necessary because "absent some kind of protection from liability, firms have an incentive to be less than frank." *Id*. When that occurs, "regulators do not receive accurate information about the reasons for terminations, prospective employers are not alerted to potential problems, and investors continue

---

[20] Galarneau acknowledges that the purpose of the U-5 is "to protect the public and the industry." JA194; *see also Acciardo v. Millennium Sec. Corp.*, 83 F. Supp. 2d 413, 419 (S.D.N.Y. 2000) ("The form is designed to protect a new firm and its customers from hiring a person who has exhibited a disregard for industry regulations or policies at the former firm."); *Cicconi*, 808 N.Y.S.2d at 607 ("Only by clear descriptions of questionable conduct by brokers [on the U-5] can we best ensure that any future employers and customers have notice of any such conduct in their interactions with those brokers.").

to be exposed to problem representatives." Anne H. Wright, *Form U-5 Defamation*, 52 WASH. & LEE L. REV. 1299, 1301 (1995).

When, as here, "a conditional privilege exists, liability for defamation attaches only if the person who made the defamatory statements loses the privilege through abusing it." *Lester*, 596 A.2d at 69. The plaintiff bears the burden of proving such abuse. *See Cole v. Chandler*, 752 A.2d 1189, 1194 (Me. 2000). Abuse of the privilege occurs when the speaker acts with "express or implied malice." *Onat v. Penobscot Bay Med. Ctr.*, 574 A.2d 872, 874 (Me. 1990). Thus, to succeed on her defamation claim, Galarneau was required to prove that Merrill Lynch acted either with ill will or with knowledge of or reckless disregard for the (purported) falsity of its statement. *See id; see also Baker v. Charles*, 919 F. Supp. 41, 45 (D. Me. 1996). Galarneau, however, proved none of these things.

2. Merrill Lynch did not act with ill will, and neither knew of nor recklessly disregarded the statement's purported falsity.

Under Maine law, ill will is defined as "an actual purpose or design to cause injury to the plaintiff." *Cohen v. Bowdoin*, 288 A.2d 106, 112 (Me. 1972). Galarneau presented no evidence of such a purpose or design. There is, for example, no evidence that Merrill Lynch was motivated by "vindictiveness or retaliation" when it filed the U-5 as required by law. *Cf. Baker*, 919 F. Supp. at 45. Nor is there any evidence that any of the Merrill Lynch employees involved in the deci-

sion to terminate Galarneau bore her any "personal animosity." *Cf. Lavin v. Caleb Brett USA, Inc.*, 1991 WL 338550, at *3 (D. Me. Oct. 28, 1991). Indeed, all evidence is to the contrary. Galarneau herself, for example, expressed her "appreciat[ion]" to Colbath for his "concern and guidance" during the "difficult process" of the State's investigation of Ford's complaint. JA804. Gilbert, the person who oversaw Merrill Lynch's internal investigation, had no knowledge of Galarneau prior to the investigation. JA447. Indeed, far from displaying personal animosity toward Galarneau, Gilbert, at the same time he was investigating the Ford complaint, exonerated Galarneau of any wrongdoing in connection with the Morin complaint. JA449. In short, there was no evidence from which a rational jury could conclude that Merrill Lynch acted with ill will toward Galarneau.[21]

Nor was there any evidence, much less sufficient evidence, that Merrill Lynch's statements "were made with knowledge of their falsity or with reckless disregard for their truth or falsity." *Ballard v. Wagner*, 877 A.2d 1083, 1088 (Me. 2005). "Knowledge or disregard of falsity is a purely subjective state of mind." *Lester*, 596 A.2d at 71. Insofar as Merrill Lynch's U-5 statement was true (*see* pages 7–12 *supra*), Merrill Lynch could not possibly have known of or recklessly disregarded its falsity. But even if the statement were false, Galarneau did not

---

[21] To have succeeded on an ill-will theory, Galarneau would have had to prove that Merrill Lynch acted "*solely* out of spite or ill will." *Lester*, 596 A.2d at 70.

present sufficient evidence to prove that Merrill Lynch acted with reckless disregard for—let alone had actual knowledge of—its falsity.

"Evidence is sufficient to support a finding of reckless disregard for the truth if it establishes that the maker of a statement had 'a high degree of awareness of probable falsity or serious doubt as to the truth of the statement.'" *Rippett v. Bemis*, 672 A.2d 82, 87 (Me. 1996) (quoting *Onat*, 574 A.2d at 874). Here, however, the evidence demonstrates that Merrill Lynch genuinely (and reasonably) believed that Galarneau had engaged in inappropriate bond trading.

Prompted by Ford's detailed complaint, Merrill Lynch conducted a thorough investigation of Galarneau's trading. *See* pages 7–11 *supra*. That investigation revealed a pattern of trading that was "[h]ighly excessive" and "didn't make a lot of sense." JA406; JA409. In particular, the investigation revealed a series of short-term trades in long-term bonds that cost Ford $90,000 in losses, and tens of thousands more in commissions and interest. JA403–JA404. Based on those findings, the Merrill Lynch employees charged with investigating the complaint concluded—rightly or wrongly, but in any event sincerely—that Galarneau had, as stated in the U-5, engaged in inappropriate bond trading. *See* pages 11–12 *supra*. Merrill Lynch was entitled to rely on the results of its internal investigation, and did not abuse the conditional privilege in so doing. *See Rice v. Alley*, 791 A.2d

932, 937 (Me. 2002) (finding no abuse of the privilege where maker of allegedly defamatory statement relied on results of investigation by responsible person).[22]

Indeed, Galarneau herself admits that a person looking at the Bates report might "draw the conclusion that we had done something wrong." JA468. That admission precludes any finding that Merrill Lynch recklessly disregarded the purported falsity of its U-5 statement.

Because Galarneau proved neither falsity nor malice, Merrill Lynch is entitled to JMOL on the defamation claim.

II. THE DISTRICT COURT ERRED IN EXCLUDING EVIDENCE RELATING TO THE DRAFTING OF THE U-5.

If, based on the evidence presented, the jury was entitled to find Merrill Lynch liable for defamation, it is only because that evidence was incomplete. By erroneously excluding Merrill Lynch's January 29, 2004, letter and Galarneau's February 5, 2004, letter (*see* pages 13–14 *supra*), the district court prevented the jury from learning that:

- Merrill Lynch, although not required to do so, had allowed Galarneau to comment on a draft of the U-5 before it was filed;

[22] Even if the investigation had been inadequate, that "by itself is clearly not sufficient to show actual malice." *Duffy v. Leading Edge Prods., Inc.*, 44 F.3d 308, 315 (5th Cir. 1995), *cited with approval in Cole,* 752 A.2d at 1194.

- In response to Merrill Lynch's draft, Galarneau had proposed using substantially similar language to describe the reasons for her termination; and,
- At Galarneau's behest, Merrill Lynch included a statement in the U-5 noting Galarneau's disagreement with the company's substantive conclusions.

Had the jury been allowed to consider these facts, it could not possibly have found that Merrill Lynch acted with malice, let alone with the degree or type of malice necessary to impose punitive damages. Exclusion of the evidence was prejudicial error, and Merrill Lynch is therefore, at minimum, entitled to a new trial.

A. Evidence Relating To The Drafting Of The U-5 Was Not Excludable Under Rule 408.

The trial court excluded the parties' respective letters under Rule 408. But Rule 408 is inapplicable for several reasons.

1. The communications were not offers to settle a disputed claim.

At the time of trial, Rule 408 provided that "[e]vidence of * * * offering * * * a valuable consideration in * * * attempting to compromise a claim which was disputed as to either its validity or amount, is not admissible to prove liability for or invalidity of the claim."[23] Thus, to be excludable under that provision, a communication must have been (i) an offer of "valuable consideration" (ii) to settle

[23] Rule 408 was amended effective December 1, 2006.

"a claim which was disputed" at the time of the offer. Neither requirement is satisfied here.

(a) There was no offer of valuable consideration.

Neither Merrill Lynch's letter to Galarneau nor Galarneau's letter to Merrill Lynch contained an offer of valuable consideration. Merrill Lynch's letter did nothing more than transmit the U-5 language then under consideration. *Cf.* A42–A43. Galarneau's letter in response proposed alternative language, but contained no offer of valuable consideration in the event Merrill Lynch accepted Galarneau's proposal. *Cf.* A45–A46. Galarneau did not, for example, offer to release Merrill Lynch from any claim in exchange for its adoption of her preferred language.

It is well established that communications that simply assert a party's position or that convey an unconditional request or offer do not fall within the ambit of Rule 408. *See, e.g.*, *Lightfoot v. Union Carbide Corp.*, 110 F.3d 898, 909 (2d Cir. 1997) (unconditional offer was not a settlement offer because "an unconditional offer may not require the [offeree] to abandon or modify his suit"); *Winchester Packaging, Inc. v. Mobil Chem. Co.*, 14 F.3d 316, 319 (7th Cir. 1994) (statement that "itemizes what the sender thinks the recipient owes him and demands—even under threat of legal action—payment is not an offer in settlement or a document in settlement negotiations and hence is not excludable by force of Rule 408"); *Dimino v. New York City Transit Auth.*, 64 F. Supp. 2d 136, 163 (E.D.N.Y. 1999)

(defendant's statements were not settlement offers under Rule 408 because they "did not require that [the plaintiff] release any claims" and did not offer "to trade any valuable consideration for any compromise of a claim"); *Kraemer v. Franklin & Marshall Coll.*, 909 F. Supp. 267, 268 (E.D. Pa. 1995) (letter was merely "a demand * * * accompanied by a threat of legal action" and therefore "not an offer to settle a claim" under Rule 408). Under this settled law, neither of the letters was subject to exclusion under Rule 408.

(b) There was no disputed claim.

Because defamation requires "an unprivileged publication to a third party" (*Lester*, 596 A.2d at 69), Galarneau's defamation claim did not accrue until the U-5 was filed on February 6, 2004. Therefore, at the time the excluded letters were exchanged—on January 29 and February 5—there was, with respect to the U-5, no "claim which was disputed as to either its validity or amount." *Cf.* BLACK'S LAW DICTIONARY 240 (7th ed. 1999) (defining "claim," in part, as "[t]he assertion of an *existing* right") (emphasis added).

Accordingly, even if the letters did constitute settlement offers, they were not subject to exclusion under Rule 408 because the rule excludes only those offers made to compromise "actual disputes over *existing* claims." *Deere & Co. v. Int'l Harvester Co.*, 710 F.2d 1551, 1557 (Fed. Cir. 1983) (emphasis added); *accord Johnson v. Land O'Lakes, Inc.*, 181 F.R.D. 388, 392 (N.D. Iowa 1998) ("the 'trig-

ger' for application of Rule 408" is "the existence of an actual dispute as to existing claims"); *see also Crues v. KFC Corp.*, 768 F.2d 230, 233 (8th Cir. 1985) (statements not excludable because "Rule 408 applies only to an offer to compromise a 'claim,' and it is not clear that [plaintiff] had a claim" at the time the statements were made).[24]

2. The evidence was in any event admissible because it was offered to prove Merrill Lynch's state of mind.

"Rule 408 is not an absolute ban on all evidence regarding settlement negotiations." *Bankcard Am., Inc. v. Universal Bancard Sys.*, 203 F.3d 477, 484 (7th

---

[24] Just as Rule 408 bars evidence of settlement offers only when such evidence is introduced "to prove liability for or invalidity of the claim" that was the subject of the offer, the rule "likewise" requires exclusion of evidence of statements made during compromise negotiations only when those negotiations concerned the claim currently in dispute. Fed. R. Evid. 408. Accordingly, the rule does *not* bar evidence of statements made during compromise negotiations that "involved a different claim than the one at issue in the current trial." *Broadcort Capital Corp. v. Summa Med. Corp.*, 972 F.2d 1183, 1194 (10th Cir. 1992). Here, even if there had been compromise negotiations relating to Galarneau's termination at the time the letters were exchanged, those negotiations could not have related to Galarneau's as-of-then nonexistent defamation claim. Accordingly, the letters were not excludable as statements made during compromise negotiations. *See Deluca v. Allied Domecq Quick Serv. Rests.*, 2006 WL 2713944, at *2 (E.D.N.Y. Sept. 22, 2006) (statement made during settlement discussions held prior to accrual of the claim at issue in trial was not inadmissible under Rule 408 because those discussions related to other claims); *see also Uforma/Shelby Bus. Forms, Inc. v. NLRB*, 111 F.3d 1284, 1293–94 (6th Cir. 1997) ("'Rule 408 only bars the use of compromise evidence to prove the validity or invalidity of the claim that was the subject of the compromise, not some other claim.'") (quoting 23 Charles Alan Wright & Kenneth W. Graham, Jr., FEDERAL PRACTICE & PROCEDURE § 5314 n.25 (1st ed. 1980)).

Cir. 2000). Only evidence that is offered "to prove liability for or invalidity of the claim or its amount" is excludable under the rule. By its terms, the rule "does not require exclusion when the evidence is offered for another purpose." Fed. R. Evid. 408. Accordingly, this Court, like others, has recognized that Rule 408 does not bar evidence of settlement discussions when that evidence is offered to prove a party's motive or state of mind.[25] For example, recognizing the "flexibility" of the rule, this Court has approved the admission of settlement evidence that went to the defendant's bad faith and helped explain the plaintiff's failure to mitigate damages. *Urico v. Parnell Oil Co*., 708 F.2d 852, 853–54 (1st Cir. 1983). That holding is dispositive here because the letters were offered for "another purpose"—namely, to prove Merrill Lynch's state of mind.

The excluded letters are crucial evidence that Merrill Lynch did not act with malice. First, the fact that Merrill Lynch voluntarily provided Galarneau an oppor-

[25] Courts routinely admit evidence of settlement negotiations when such evidence is relevant to a party's state of mind, even when state of mind is an element of a claim or defense. *See, e.g.*, *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 770 (10th Cir. 1997) (approving admission of compromise evidence to show defendant's bad faith); *United States v. Hauert*, 40 F.3d 197, 199–200 (7th Cir. 1994) (approving admission of settlement statements to show defendant's knowledge and intent); *Johnson v. Hugo's Skateway*, 974 F.2d 1408, 1412–13 (4th Cir. 1992) (en banc) (approving admission of prior settlement to show defendant's racial animus); *Wegerer v. First Commodity Corp.*, 744 F.2d 719, 723–24 (10th Cir. 1984) (approving admission of prior settlement "for the limited purpose of showing intent and knowledge" where evidence was "crucial" to punitive damages claim).

tunity to comment on a draft of the U-5 before it was filed is powerful evidence that Merrill Lynch did not act out of ill will or with reckless disregard for the truth.[26] Second, the fact that, in response to Merrill Lynch's draft, Galarneau herself proposed language that was substantially similar to the description Merrill Lynch employed strongly undermines her later allegation that Merrill Lynch knew or recklessly disregarded the (purported) falsity of that description. Third, Merrill Lynch's inclusion of the statement that "Galarneau disagrees with the Firm's conclusions" in response to Galarneau's request was further evidence that Merrill Lynch harbored no ill will toward Galarneau.[27]

3. Excluding evidence of Galarneau's proposed U-5 language gave her an unfair litigation advantage in contravention of the rule's purposes.

Consistent with the limited scope of the rule, courts have recognized that Rule 408 should not be employed in a way that would give an unfair advantage to the party invoking it. In *Bankcard*, for example, the plaintiff had, in the course of settlement negotiations, led the defendant to believe that the plaintiff would not ob-

---

[26] Merrill Lynch's only obligation under art. V, § 3(a) of the NASD By-Laws was to provide Galarneau a copy of the U-5 "as filed with the NASD."

[27] The trial court recognized that inclusion of "the disclaimer language * * * may be a good argument in terms of malice" (A36), but precluded Merrill Lynch from explaining to the jury that its inclusion was the result of Merrill Lynch's effort to accommodate Galarneau's wishes.

ject if the defendant took certain actions that violated the parties' contract. In words that resonate here, the Seventh Circuit held that "it would be an abuse of Rule 408 to let [the plaintiff] lull [the defendant] into breaching the contract and then prevent [the defendant] from explaining its actions because the lulling took place around the settlement table." *Bankcard*, 203 F.3d at 484. Noting that the evidence "was admitted to show [the defendant's] state of mind and to explain" the defendant's actions, the Seventh Circuit recognized that "[t]o use Rule 408 to block evidence that the violation of the contract was invited would be unfair." *Id.*

So, too, here. In her letter to Merrill Lynch, Galarneau responded to the U-5 draft by "request[ing]" that Merrill Lynch state that she had been terminated, *inter alia*, for "bond related trades" that the firm considered "not appropriate." A45–A46. That request surely invited Merrill Lynch to believe that Galarneau would not later claim that a substantially similar phrase—"inappropriate bond trading"—was in fact defamatory. It was "an abuse of Rule 408" to allow Galarneau to "lull" Merrill Lynch into believing that she had no substantive disagreement with the company's description of its reasons for terminating her and then exclude evidence

of "the lulling" because it (allegedly) "took place around the settlement table." *Bankcard*, 203 F.3d at 484.[28]

B. Evidence Relating To The Drafting Of The U-5 Was Not Excludable Under Rule 403.

It was also reversible error to exclude the letters under Rule 403. Rule 403 provides that a trial court may exclude relevant evidence "if its probative value is substantially outweighed by the danger of unfair prejudice." As this Court has repeatedly emphasized, the issue under Rule 403 "is one of *unfair* prejudice." *Faigin v. Kelly*, 184 F.3d 67, 82 (1st Cir. 1999) (emphasis in original); *see also Onujiogu v. United States*, 817 F.2d 3, 6 (1st Cir. 1987). All evidence is prejudicial in the sense that it helps one litigant and hurts the other. Thus, the mere fact that admission of certain evidence would harm one side's chance of prevailing at trial "is not a basis for judicial exclusion of probative evidence." *Faigin*, 184 F.3d at 82.

---

[28] The purpose of Rule 408 "is to facilitate the settlement of disputes by encouraging the making of offers to compromise" (*S.A. Healy Co. v. Milwaukee Metro. Sewerage Dist.*, 50 F.3d 476, 480 (7th Cir. 1995)), and its "spirit and purpose must be considered in its application." *Bankcard*, 203 F.3d at 484. Here, admission of the letters would not thwart the rule's purpose. On the contrary, "if parties know they cannot be seduced into action only to be blind-sided later," they will be "encourage[d]" to enter "negotiations and settlements." *Savoy IBP 8, Ltd. v. Nucentrix Broadband Networks, Inc.*, 333 B.R. 114, 123 n.9 (N.D. Tex. 2005) (affirming admission of evidence that one party induced reliance by the other during settlement negotiations).

Here, neither Galarneau nor the district court ever identified any *unfair* prejudice that would result from admission of the letters, let alone unfair prejudice that "substantially outweighed" their considerable probative value. Indeed, when the court issued its initial ruling at the pre-trial hearing, it did not even mention Rule 403. When it reaffirmed that ruling on the opening day of trial, it mentioned Rule 403 only in passing and provided no analysis of what unfair prejudice, if any, was sufficiently weighty to justify the letters' exclusion. Although the court did mention that their admission could "open[] doors that might well require counsel to testify" (A36), it is far from obvious that such testimony would have been necessary;[29] even if it were, there is, to our knowledge, no authority for the proposition that the risk of counsel being called to testify constitutes grounds for excluding otherwise admissible evidence under Rule 403. Moreover, rather than exclude the letters altogether, the court could have taken a "less intrusive measure[] to minimiz[e]" any unfairly prejudicial effect, which is the "preferred" course because "the Federal Rules of Evidence favor the admissibility of evidence." *Rubert-Torres v. Hosp. San Pablo, Inc.*, 205 F.3d 472, 479 (1st Cir. 2000). The court could, for example, have given a limiting instruction and narrowly circumscribed the testimony, if any, that accompanied the letters' admission.

---

[29] As noted by Merrill Lynch during argument on Galarneau's motion *in limine*, the letters and the U-5 speak for themselves. A33.

Given that the letters were highly probative of Merrill Lynch's state of mind, whatever unfair prejudice may have attended their admission did not substantially outweigh their probative value. It was, therefore, error to exclude them under Rule 403, as under Rule 408.

III. THERE WAS INSUFFICIENT EVIDENCE THAT GALARNEAU'S LOST WAGES WERE CAUSED BY THE ALLEGEDLY DEFAMATORY STATEMENT.

The district court correctly instructed the jury that to receive damages on her defamation claim Galarneau had to prove that the purportedly defamatory statement "play[ed] a substantial part in bringing about or actually causing the injury or damage." JA480. As Maine courts have consistently held, "'[t]he mere possibility of such causation is not enough'" to satisfy this requirement. *Champagne v. Mid-Maine Med. Ctr.*, 711 A.2d 842, 845 (Me. 1998) (quoting RESTATEMENT (SECOND) OF TORTS § 433B cmt. a (1965)). "To support a finding of proximate cause, there must be some evidence indicating that a foreseeable injury did in fact result." *Merriam v. Wanger*, 757 A.2d 778, 781 (Me. 2000). "[W]hen the matter remains one of pure speculation or conjecture, or even if the probabilities are evenly balanced, a defendant is entitled to a judgment." *Id.* Maine law compels the court "to direct a verdict for the defendant if the jury's determination of proximate cause would be based on speculation or conjecture." *Cyr v. Adamar Assocs. Ltd. P'ship*,

752 A.2d 603, 604 (Me. 2000); *accord Merriam*, 757 A.2d at 781 (reversing jury verdict where record contained insufficient evidence of proximate causation).

Here, Galarneau failed to adduce sufficient evidence to prove that her lost wages were proximately caused by the statement that she had engaged in "inappropriate bond trading." The only evidence presented on this issue was Galarneau's own testimony that she was unsuccessful in getting a job with three other brokerage firms (JA129–JA130), and that it is generally "very difficult" to find employment after being accused "of doing something wrong in a customer's account" (JA193). Such testimony is insufficient. To prove causation, Galarneau was required to offer evidence from prospective employers as to why they did not hire her. As Judge Sack has noted, "where the plaintiff claims that a particular loss has resulted from actions taken by third parties on the basis of a defamatory statement, courts have required that the plaintiff produce testimony of the third parties to establish that the publication did indeed cause the loss." 1 Robert D. Sack, SACK ON DEFAMATION § 10.5.3 (3d ed. 1999) (collecting cases).

Inferring causation is particularly problematic in this case because there was substantial evidence of alternative explanations for why Galarneau was not hired by another employer, including (i) her admitted utilization of time and price discretion (JA471); (ii) the Ford complaint (JA493–JA494); (iii) Merrill Lynch's publicly reported $100,000 settlement of that complaint (JA544–JA545; JA406–

JA407); and (iv) the state's ongoing investigation of Galarneau's conduct (JA501–JA504). There is no evidence suggesting that the alleged defamatory statement—rather than these alternative explanations or some other cause—resulted in her inability to secure employment. Because the "mere possibility of * * * causation is not enough" (*Merriam*, 757 A.2d at 781), the necessarily speculative award of $775,000 for lost wages (A22) was improper under Maine law.

IV. THE EVIDENCE WAS INSUFFICIENT TO SUPPORT LIABILITY FOR PUNITIVE DAMAGES.

Taken together, Maine law and the First Amendment require a dual showing for punitive damages to be awarded. Under the First Amendment, "States may not permit recovery of * * * punitive damages * * * when liability is not based on a showing of knowledge of falsity or reckless disregard for the truth." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 349 (1974); *see also Levinsky's*, 127 F.3d at 128. Under Maine law, proof of knowledge or reckless disregard—although necessary under the First Amendment—is not sufficient. Rather, the plaintiff must also prove that "the defendant was motivated by 'ill will' toward the plaintiff, or acted so 'outrageously' that malice could be inferred." *Veilleux v. Nat'l Broad. Co.*, 206 F.3d 92, 135 (1st Cir. 2000) (affirming denial of punitive damages because evidence, although sufficient to show that the statements were made knowingly or recklessly, did not prove ill will or outrageous conduct); *see also Tuttle v. Raymond*, 494 A.2d 1353, 1361 (Me. 1985) ("We emphasize that, for the purpose of

assessing punitive damages, such 'implied' or 'legal' malice will *not* be established by the defendant's mere reckless disregard of the circumstances.") (emphasis in original).

Moreover, both the First Amendment and Maine law demand that the requisite showings be made by clear and convincing evidence. *See Bose*, 466 U.S. at 511 n.30 (First Amendment requires "the plaintiff to demonstrate with clear and convincing evidence that the defendant realized that his statement was false or that he subjectively entertained serious doubt as to the truth of his statement"); *Dalbec v. Gentleman's Companion, Inc.*, 828 F.2d 921, 928 (2d Cir. 1987) ("As required under the First Amendment, the jury was instructed that it could not award punitive damages unless it found by 'clear and convincing evidence' that the * * * statement was published with 'knowledge of falsity or reckless disregard for the truth.'") (citation omitted); *Staples v. Bangor Hydro-Elec. Co.*, 629 A.2d 601, 604–05 (Me. 1993) (reversing award of punitive damages because, "although [plaintiff] met his burden of proving ill will by the preponderance standard, * * * the evidence was insufficient to meet the higher clear and convincing standard"); *see also Veilleux*, 206 F.3d at 135.

Thus, while a defamation plaintiff may defeat the conditional privilege and obtain *compensatory* damages by proving *either* ill will *or* reckless disregard of the truth/actual knowledge of falsity by *a preponderance of the evidence* (*see* page 30

supra), to obtain *punitive* damages Galarneau had to prove *both* ill will/outrageous conduct *and* reckless disregard/knowledge of falsity by *clear and convincing evidence*. Galarneau failed to meet her heavy evidentiary burden.

First, she presented no evidence, much less 'clear and convincing' evidence, that Merrill Lynch either knew of or recklessly disregarded the purported falsity of the U-5 statement. *See* pages 31–33 *supra*. Nor did she present clear and convincing evidence of ill will or outrageous conduct. To satisfy the 'clear and convincing' standard, Galarneau "had the burden of proving *the high probability* that" Merrill Lynch "was motivated by ill will" or that Merrill Lynch's "conduct was so *outrageous* that malice can be implied." *Staples*, 629 A.2d at 604 (emphasis in original). As discussed above (at pages 30–31), Galarneau failed to adduce *any* evidence—let alone clear and convincing evidence—of ill will.

Galarneau also failed to adduce any evidence of outrageous conduct. The threshold for finding outrageous conduct is very high. In *Tuttle* for example, the Supreme Judicial Court of Maine "denied a claim for punitive damages where a driver sped through city streets, ran a stoplight, and struck the plaintiff's vehicle with enough force to shear it in half." *Curran v. Richardson*, 448 F. Supp. 2d 228, 232 (D. Me. 2006) (granting summary judgment on punitive damages to defendant who caused accident by driving on wrong side of the road). Here, Merrill Lynch's conduct did not come close to, let alone exceed, that high threshold. *Cf. Smith v.*

Heritage Salmon, Inc., 180 F. Supp. 2d 208, 223–24 (D. Me. 2002) (false allegation of workplace sabotage and cover-up, which resulted in plaintiff's termination, was not sufficiently outrageous to give rise to punitive damages); *Staples*, 629 A.2d at 604 (reversing award of punitive damages although supervisor's false and defamatory accusation resulted in plaintiff's dismissal). Far from engaging in outrageous conduct, Merrill Lynch did nothing more than fulfill its legal obligation to file a report setting forth, after thorough investigation, the reasons for Galarneau's termination.

Because Galarneau was required to prove *both* ill will or outrageous conduct *and* knowledge of falsity or reckless disregard for the truth by clear and convincing evidence but in fact proved neither, the punitive award must be reversed.

V. THE PUNITIVE DAMAGES ARE UNCONSTITUTIONALLY EXCESSIVE.

After awarding Galarneau a substantial compensatory award of $850,000 for primarily economic injuries arising from the alleged defamation, the jury also awarded her an extraordinary $2,100,000 in punitive damages based on the same allegedly tortious conduct. The punitive damages award is unconstitutionally excessive under the circumstances of this case.

As the Supreme Court has noted, a $2,000,000 punitive damages award is "tantamount to a severe criminal penalty" and may be awarded only for "egregiously improper conduct." *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 580, 585

(1996). Here, however, Merrill Lynch's actions do not constitute "egregiously improper conduct" meriting such an award. Indeed, a multimillion-dollar award is especially inappropriate in this case because the allegedly tortious conduct occurred during fulfillment of a legally required, constitutionally protected, and socially useful duty, namely, the report to official regulators of the reasons why a registered securities broker was terminated.

The Supreme Court has outlined three "guideposts" for lower courts to consider in determining whether a punitive award is unconstitutionally excessive under the Due Process Clause: (1) the degree of reprehensibility of the misconduct; (2) the ratio of punitive to compensatory damages; and (3) the civil penalties applicable to comparable conduct. *See State Farm*, 538 U.S. at 417–18. "Exacting appellate review" employing these guideposts is necessary to ensure that punitive damages are "based upon an application of law, rather than a decisionmaker's caprice." *Id.* at 418 (internal quotation marks omitted). That "[e]xacting" review compels the conclusion that the award of $2,100,000 in punitive damages in this case is unconstitutionally excessive.

A. Merrill Lynch's Alleged Conduct Was Not Sufficiently Reprehensible To Merit A Punitive Award Of Over $2 Million.

"The most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." *Id.* at 419. In short, "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). Thus, "[i]n order to justify a substantial punitive damage award, a plaintiff ordinarily must prove that the defendants' conduct falls at the upper end of the blameworthiness continuum, or, put another way, that the conduct reflects a high level of culpability." *Zimmerman v. Direct Fed. Credit Union*, 262 F.3d 70, 82 (1st Cir. 2001). Accordingly, the Supreme Court has instructed reviewing courts to consider a non-exclusive list of factors bearing on the degree of reprehensibility, including: (1) whether "the harm caused was physical as opposed to economic"; (2) whether "the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others"; (3) whether "the target of the conduct had financial vulnerability"; (4) "whether the conduct involved repeated actions or was an isolated incident"; and (5) whether "the harm was the result of intentional malice, trickery or deceit, or mere accident." *State Farm*, 538 U.S. at 419.

When analyzed in terms of these factors, it is clear that Merrill Lynch's conduct does not "fall[] at the upper end of the blameworthiness continuum"—or anywhere close to it. *Zimmerman*, 262 F.3d at 82. First, the harm allegedly inflicted by the U-5 was in no sense physical. Second, and similarly, Merrill Lynch's filing of the U-5 certainly did not "evince[] an indifference to or a reckless disregard of the health or safety of others." Third, the record belies any claim that Galarneau was "financial[ly] vulnerab[le]," much less that she was "target[ed]" be-

cause of any such vulnerability. *See In re Exxon Valdez*, 2006 WL 3755189, at *17 (9th Cir. Dec. 22, 2006) ("there must be some kind of intentional aiming or targeting of the vulnerable"). Galarneau was in no way "the weakest of the herd" (*State Farm*, 538 U.S. at 433 (Ginsburg, J., dissenting)); rather, she is an affluent "community leader" who serves on the Portland Symphony Orchestra board of directors. JA2. Fourth, Merrill Lynch's conduct plainly cannot be construed as involving "repeated actions"; the filing of Galarneau's U-5 was necessarily an "isolated incident."

The evidence introduced at trial also demonstrates that Merrill Lynch did not engage in "intentional malice, trickery or deceit." Although the jury concluded that Merrill Lynch had acted with malice, this Court is required to conduct its own "independent review" of the evidence to determine whether intentional malice has been sufficiently proven. *Bose Corp.*, 466 U.S. at 499; *see also BMW*, 517 U.S. at 580, 606 (holding that "this case exhibits none of the circumstances ordinarily associated with egregiously improper conduct" notwithstanding jury's finding that the conduct entailed "'gross, oppressive or malicious' fraud"). As discussed in detail above (at pages 28–33), such malice is completely lacking in this case.

In short, none of the *State Farm* factors is present; that fact "renders *any* award suspect." *State Farm*, 538 U.S. at 419 (emphasis added). But even if this Court were to find one factor present, that alone "may not be sufficient to sustain a

punitive damages award." *Id*. That is especially so here, given the deterrent effect of the large compensatory award and the dire consequences of over-deterrence in this area.

B. The Ratio Of Punitive To Compensatory Damages Is Unreasonable Given The Size Of The Compensatory Award.

The second guidepost is the ratio of punitive to compensatory damages. *See BMW*, 517 U.S. at 580. In applying this guidepost, "the Supreme Court has 'dismissed any simple, mathematical formula in favor of general inquiry into reasonableness.'" *Casillas-Diaz v. Palau*, 463 F.3d 77, 86 (1st Cir. 2006) (quoting *Romano v. U-Haul Int'l*, 233 F.3d 655, 673 (1st Cir. 2000)). Courts are therefore instructed to "ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered." *State Farm*, 538 U.S. at 426.

Although the approximately 2.5:1 ratio of punitive to compensatory damages in this case may not at first glance appear excessive, "[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." *Id*. at 425. The jury awarded Galarneau $850,000 in compensatory damages, which is unquestionably a "substantial" sum—especially given that Merrill Lynch did not reap any

financial benefit from its conduct.[30] Consequently, "a lesser ratio" will likely represent the constitutional maximum.

For instance, even before *State Farm* this Court reduced a $3,000,000 punitive award to $300,000 in a race discrimination case because "[t]he large compensatory damage award" of $299,000 "provide[d] significant deterrence, even to employers as large as [the defendant]." *Rowlett v. Anheuser-Busch, Inc.*, 832 F.2d 194, 206 (1st Cir. 1987), *abrogated on other grounds by Iacobucci v. Boulter*, 193 F.3d 14, 27 (1st Cir. 1999); *accord Williams v. ConAgra Poultry Co.*, 378 F.3d 790, 799 (8th Cir. 2004) ("substantial" compensatory damages award of $600,000 in harassment suit militated in favor of reducing punitive award from $6,000,000 to $600,000); *Boerner v. Brown & Williamson Tobacco Co.*, 394 F.3d 594, 602–03 (8th Cir. 2005) ("a ratio of approximately 1:1" was constitutional maximum where compensatory damages were "substantial" and misconduct was "highly reprehen-

---

[30] When, as here, the compensatory damages materially exceed the actual and expected gain from the misconduct, they have the exact same deterrent effect as punitive damages. In such circumstances, there is generally no need for any substantial amount of punitive damages. *See Alicea Rosado v. Garcia Santiago*, 562 F.2d 114, 121 (1st Cir. 1977) (vacating punitive award because compensatory damages were "a sufficient deterrent to future wrongdoing"); *Lane v. Hughes Aircraft Co.*, 993 P.2d 388, 400–01 (Cal. 2000) (Brown, J., concurring) ("large compensatory damage awards not based on a defendant's ill-gotten gains have a strong deterrent and punitive effect in themselves"); *see also State Farm*, 538 U.S. at 419 ("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").

sible”); *Casumpang v. Int’l Longshore & Warehouse Union Local 142*, 411 F. Supp. 2d 1210, 1221–22 (D. Haw. 2005) (reducing $1,000,000 punitive award to $240,000—the amount of the compensatory damages—in part because of “the substantial compensatory damages”); *Czarnik v. Illumina, Inc.*, 2004 WL 2757571, at *11 (Cal. Ct. App. Dec. 3, 2004) (“1:1 ratio of punitive to compensatory damages [was] the [constitutional] maximum” where compensatory damages were significant and misconduct “was not highly reprehensible”).

C. Comparison With Other U-5 Defamation Cases Demonstrates The Excessiveness Of This Punitive Award.

The final guidepost is “the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.” *State Farm*, 538 U.S. at 418. This guidepost is important because a reviewing court “should accord substantial deference to legislative judgments concerning appropriate sanctions for the conduct at issue.” *BMW*, 517 U.S. at 583 (internal quotation marks omitted). Here, there is no legislatively established penalty for the conduct at issue, which is itself an indication that a $2,100,000 punitive damages award is excessive. *See, e.g., FDIC v. Hamilton*, 122 F.3d 854, 862 (10th Cir. 1997) (reducing $1,200,000 punitive award to $264,000 in part because the tortious conduct was not subject to criminal or civil fines).

The third guidepost also helps determine whether the defendant had “fair notice” that it could be subjected to a penalty of the size of the punitive award.

BMW, 517 U.S. at 584. In this respect, it is sometimes appropriate to consider whether there "have been any judicial decision[s] * * * indicating that [the conduct at issue] might give rise to such severe punishment." *Id.* This Court accordingly has looked to other cases involving similar conduct "to determine whether a particular defendant was given fair notice as to its potential liability for particular misconduct." *Davis v. Rennie*, 264 F.3d 86, 117 (1st Cir. 2001).

The $2,100,000 punitive award in this case appears to be the largest such award ever imposed for defamation under Maine law. Furthermore, an examination of other cases involving (purportedly) defamatory statements on U-5s indicates that plaintiffs alleging similar—if not more egregious—conduct have consistently been awarded *significantly* smaller amounts of punitive damages. *See, e.g., Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132 (6th Cir. 1996) (award of $750,000 in punitive damages based on defamatory U-5 statement that employee was under investigation for stealing firm property); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 834 F. Supp. 1023 (N.D. Ill. 1993), *aff'd*, 28 F.3d 704 (7th Cir. 1994) (award of $120,000 in punitive damages based on "unconscionable" statement in U-5 that employee was under investigation for stealing firm property); *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 514, 516 (2d Cir. 1991) (award of $100,000 in punitive damages for defamation on U-5 where employer had engaged in "flagrantly spiteful conduct, demonstrating its intent simply to injure [the former em-

ployee's] reputation"); *Acciardo v. Millennium Sec. Corp.*, 83 F. Supp. 2d 413, 416, 418 (S.D.N.Y. 2000) (award of $100,000 in punitive damages for defamatory statement on U-5 where evidence indicated that employer had also filed defamatory U-5s with respect to three other former employees). These cases strongly suggest that Merrill Lynch was not given fair notice that it could be mulcted to the tune of $2,100,000 in punitive damages.

D. A Large Punitive Award Would Frustrate The Public Interest In Accurate Filings Regarding The Conduct Of Securities Brokers.

This Court has noted that the three *BMW* "guideposts should [not] be treated as an analytical straightjacket" because "[o]ther pertinent factors may from time to time enter into the equation." *Zimmerman*, 262 F.3d at 81. Such is the case here. The U-5 serves an important social function by "substantially limit[ing] the ability of problem representatives to remain in the securities industry," and thereby helping to protect the general public from such individuals. Wright, *Form U-5 Defamation*, 52 WASH. & LEE L. REV. at 1300. The U-5's efficacy as "an early warning device" is diminished, however, to the extent firms have "concerns about defamation liability if they report adverse information on the Form U-5." *Id.* Imposing an extraordinarily large punitive award against Merrill Lynch on the facts of this case would deter firms from providing the full and frank disclosures that make the U-5 a valuable tool in protecting the investing public. As recognized by other courts in other contexts, overdeterrence through the imposition of an excessive punitive

award is both unconstitutional and bad public policy. *See, e.g.*, *BMW*, 517 U.S. at 584 ("a multimillion dollar penalty" may not be upheld when "a lesser deterrent" would suffice); *In re Exxon Valdez*, 270 F.3d 1215, 1244 (9th Cir. 2001) ("if," as a result of excessive punitive damages, "there is too much risk in performing some activity, the entire activity may be avoided as a preferable alternative to bearing potentially infinite costs of avoiding the harm, and society would lose the benefit of the productive activity").

E. The Punitive Award Should Be Substantially Reduced.

According to the Supreme Court, "[i]t should be presumed a plaintiff has been made whole for his injuries by compensatory damages, so 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." *State Farm*, 538 U.S. at 419. The award of $850,000 in compensatory damages is plainly sufficient to make Galarneau whole for her alleged injuries; the additional award of $2,100,000 in punitive damages is, for the reasons set forth above, unconstitutionally excessive. Merrill Lynch therefore respectfully requests that this Court follow its established practice in such cases and "ascertain the amount of punitive award that would be appropriate and order the district court to enter judgment in such amount." *Bisbal-Ramos*, 467 F.3d at 27; *accord Rowlett*, 832 F.2d at 207. Given the lack of reprehensibility in

this case, Merrill Lynch submits that the award of punitive damages, if any, should be nominal.

CONCLUSION

The Court should grant Merrill Lynch JMOL on the defamation claim. Failing that, the Court should order a new trial because the erroneous exclusion of evidence prejudiced Merrill Lynch. Failing that, the Court should reduce the compensatory damages to $75,000. Even if the Court does not grant JMOL on the defamation claim or order a new trial, the Court should grant Merrill Lynch JMOL on punitive liability. Finally, failing that, the Court should reduce the punitive award to a nominal amount.

Respectfully submitted,

____

Evan M. Tager
Andrew Tauber
MAYER, BROWN, ROWE & MAW LLP
1909 K Street, N.W.
Washington, DC 20006
(202) 263-3000 (phone)
(202) 263-3300 (fax)

James R. Erwin
PIERCE ATWOOD LLP
One Monument Square
Portland, ME 04101
(207) 791-1100 (phone)
(207) 791-1350 (fax)

Eugene Volokh
UCLA SCHOOL OF LAW
405 Hilgard Avenue
Los Angeles, CA 90095
(310) 206-3926 (phone)

Counsel for Merrill Lynch, Pierce, Fenner & Smith Incorporated

January 22, 2007

CERTIFICATE OF COMPLIANCE

I, Andrew Tauber, hereby certify that: (1) this brief complies with the type-volume limitation of Fed. R. App. P. 28.1(e)(2)(B) because it contains 13,970 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii); and, (2) this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) because it has been prepared in a proportionally spaced type-face, namely Times New Roman 14, using Microsoft Word 2002.

____

Andrew Tauber (#115032)
MAYER BROWN ROWE & MAW, LLP
1909 K Street, N.W.
Washington, DC 20006
Telephone: (202) 263-3000
Counsel for Merrill Lynch

Dated: January 22, 2007

CERTIFICATE OF SERVICE

I, Andrew Tauber, hereby certify that on January 22, 2007, I caused copies of the Corrected Brief of Defendant-Appellant Merrill Lynch, the attached Addendum, and the separate Joint Appendix in the above-captioned matter to be served by overnight courier on the following:

Rufus E. Brown, Esq.
Brown & Burke
85 Exchange Street, Suite 201
P.O. Box 7530
Portland, ME 04101

Michael A. Nelson, Esq.
Jensen, Baird, Gardner & Henry
10 Free St.
P.O. Box 4510
Portland, ME 04112-3059

____
Andrew Tauber (#115032)
MAYER BROWN ROWE & MAW, LLP
1909 K Street, N.W.
Washington, DC 20006
Telephone: (202) 263-3000
Counsel for Merrill Lynch