

**READING BETWEEN THE LINES OF *COOPER INDUSTRIES, INC.*  
v. *LEATHERMAN TOOL GROUP, INC.*, 121 S. Ct. 1678 (2001)**

**By Evan M. Tager**

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In its recently completed Term, the Supreme Court returned once again to the issue of punitive damages. The issue presented in *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*<sup>1</sup> was from all appearances a narrow one: the standard for reviewing a federal district court's determination as to whether a punitive damages award is unconstitutionally excessive. The Court concluded that such determinations should be reviewed *de novo*, a significant holding in its own right, but in the process also dropped some subtle and not so subtle clues about the way it sees a number of issues that were not directly presented.

### **Background**

The plaintiff, Leatherman Tool Group, is the manufacturer of a multifunction pocket tool known as the Pocket Survival Tool or PST. The defendant, Cooper Industries, decided to design and market a competing tool to be known as the ToolZall. Cooper planned to copy the basic features of the PST and then add a few features of its own. Because Cooper had not yet manufactured any ToolZalls in time for a major national trade show, it created a "mock-up" by making a few changes to a PST and then using that altered PST in its

advertising and marketing materials. Leatherman sued, and obtained findings that the Toolzall infringed its trademark rights and that, in using an altered PST for its advertising, Cooper engaged in unfair competition. Because no ToolZalls had actually been sold, the jury awarded no damages for the trademark claim. It found damages of \$50,000 for the unfair competition claim and imposed an additional \$4.5 million in punitive damages.

After the district court denied Cooper's post-trial motions, the Ninth Circuit vacated the finding of a trademark violation, concluding that the overall appearance of the PST was not protected by the trademark laws because the PST's features were functional. In a separate opinion, the Ninth Circuit upheld the punitive award, concluding that the district court did not abuse its discretion in holding that a \$4.5 million punishment was not unconstitutionally excessive.

### **The Supreme Court's Holding**

The Supreme Court vacated and remanded, holding that the Ninth Circuit erred in applying an abuse of discretion standard and instead should have undertaken *de novo* review. The Court reasoned that in prior cases it had "engaged in an independent examination of the relevant criteria" to deter-

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<sup>1</sup> 121 S. Ct. 1678 (2001).

mine whether criminal and civil penalties were unconstitutionally excessive.<sup>2</sup> It concluded: “Our decisions in analogous cases, together with the reasoning that produced those decisions, thus convince us that courts of appeals should apply a *de novo* standard of review when passing on district courts’ determinations of the constitutionality of punitive damages awards.”<sup>3</sup> Having concluded that the Ninth Circuit had applied the wrong standard, the Supreme Court proceeded to hold that a remand was necessary because its “own consideration” of the three factors identified in *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996), “reveals a series of questionable conclusions by the district court that may not survive *de novo* review.”<sup>4</sup>

### **Is *Cooper* Applicable In State Court?**

Because *Cooper* arose out of federal court, it is an open question whether the holding is applicable in state court. However, three clues dropped by the Court suggest that it is. First, when granting certiorari, the Court framed the issue as follows: “What is the standard of review of a trial court’s ruling on a challenge to the constitutionality of a punitive damage award?”<sup>5</sup> Hence, as written by the Court, the question was not limited to federal court. Second, in the opinion itself the Supreme Court gave no indication that state courts are free to utilize a less searching standard of review than the federal courts. To the contrary, it explained: “[O]ur decision today is *supported* by our reasoning in *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 20-21 (1991). In that case, we emphasized the importance of appellate review to ensuring that a

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<sup>2</sup> *Id.* at 1685.

<sup>3</sup> *Id.* at 1685-86.

<sup>4</sup> *Id.* at 1688.

<sup>5</sup> *See Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 121 S. Ct. 297 (2000).

jury’s award of punitive damages comports with due process.”<sup>6</sup> Because *Haslip* did arise in state court, the Supreme Court’s reliance on it in *Cooper* suggests that the Court intended its holding to be equally applicable in state and federal court. Third, two weeks after deciding *Cooper*, the Court vacated a decision of the California Court of Appeal and remanded for further consideration in light of *Cooper*.<sup>7</sup> The Court’s decision to vacate and remand, rather than deny certiorari, is further evidence that it believes its holding to be equally applicable in state court (or at least that it does not regard its decision as plainly limited to federal courts). Indeed, two state courts already have so construed it.<sup>8</sup>

### **Guidance on the Three *BMW* Guideposts**

Although *Cooper* sought review not just of the standard-of-review but also of the Ninth Circuit’s conclusion that the punitive award was constitutional, the Supreme Court limited its grant of certiorari to the former issue. Nevertheless, in the course of both resolving that issue and explaining why the standard might make a difference in this case, the Court provided some further guidance as to how lower courts should go about applying the three “guideposts” for evaluating punitive exactions that it had identified in *BMW*: (i) the degree of reprehensibility of the conduct; (ii) the ratio of the punitive damages to the plaintiff’s harm (or potential harm); and (iii) the disparity between the punitive damages

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<sup>6</sup> 121 S. Ct. at 1686 n.9 (emphasis in original).

<sup>7</sup> *San Paolo U.S. Holding Co. v. Simon*, 121 S. Ct. 2190 (2001).

<sup>8</sup> *See Acceptance Ins. Co. v. Brown*, 2001 WL 729283, at \*19 (Ala. June 29, 2001); *In re New Orleans Train Car Leakage Fire Litig.*, 2001 WL 737680 (La. Ct. App. June 27, 2001).

and the legislatively established penalties for comparable conduct.<sup>9</sup>

### The Reprehensibility Guidepost

In punitive damages litigation, plaintiffs often seek to support large punitive awards by reference not simply to the tort at issue but also to conduct that may not be considered tortious under the governing law. For example, in several states, first-party bad faith is not treated as a tort. Yet plaintiffs in third-party bad faith cases sometimes invoke allegations of improper first-party claims handling to justify a high punishment.

The Court confronted an analogous problem in *Cooper*. The jury in *Cooper* was presented with evidence of both non-punishable conduct (the copying of Leatherman's tool) and punishable conduct (the use of a likeness of Leatherman's tool in Cooper's advertising and marketing material). The Supreme Court made clear that the Ninth Circuit was required to determine whether the punitive award was constitutional solely by reference to the punishable conduct, something the record did not reflect that it had done.<sup>10</sup> Thus, *Cooper* can be taken as a strong signal to reviewing courts that they have an obligation to sort out the punishable from the non-punishable when determining whether the degree of reprehensibility of the conduct supports the punitive award.

### The Ratio Guidepost

It is common in punitive damages litigation — including in bad faith cases — for plaintiffs to seek and defend large punitive awards on the ground that the conduct at issue is part of a larger scheme that affected many

other individuals besides the plaintiff. In describing the second *BMW* guidepost, the Court twice specifically limited the denominator of the punitive/compensatory ratio to the harm suffered by the plaintiff<sup>11</sup> and nowhere in the opinion so much as hinted that it might be permissible to include in the ratio injuries to individuals other than the plaintiff. Accordingly, *Cooper* should be of assistance in responding to efforts to justify high punitive/compensatory ratios by reliance on injuries suffered by individuals other than the plaintiff.

Another frequently recurring issue involves the circumstances in which it is permissible to include “potential” harm in the denominator of the ratio. The Court indicated in *BMW* that, for potential harm to be considered, it has to have been “likely” to occur.<sup>12</sup> The Court re-enforced that limitation in *Cooper*, indicating that “unrealistic” measures of potential harm should be disregarded.<sup>13</sup>

### The Comparative Fines Guidepost

The Supreme Court indicated in *BMW* that courts reviewing punitive awards for excessiveness must conduct a comparison with the applicable fines for comparable conduct.

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<sup>11</sup> See *id.* at 1685 (characterizing the second guidepost as “the relationship between the penalty and the harm *to the victim* caused by the defendant's actions”) (emphasis added); *id.* at 1687 (characterizing the second guidepost as “the disparity between the harm (or potential harm) *suffered by the plaintiff* and the punitive damages award”) (emphasis added).

<sup>12</sup> *BMW*, 517 U.S. at 581. See also *Pulla v. Amoco Oil Co*, 72 F.3d 648, 659-60 (8th Cir.1995) (retired Supreme Court Justice White, sitting by designation).

<sup>13</sup> *Cooper*, 121 S. Ct. at 1688-89.

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<sup>9</sup> *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574-85 (1996).

<sup>10</sup> *Cooper*, 121 S. Ct. at 1688.

Punitive damages defendants typically urge reviewing courts to consider the fines that actually have been imposed or realistically could be imposed, given the state's fining practice, for the same or similar conduct. Plaintiffs, by contrast, generally attempt to portray the defendant as a criminal enterprise and its conduct as part of a massive fraud or conspiracy and claim that, as such, the defendant's employees could face imprisonment and the company itself could face millions of dollars in fines.

In *Cooper*, the parties engaged in an analogous debate. Cooper contended that the relevant fine was the \$25,000 maximum penalty for a violation of the Oregon Unlawful Trade Practices Act, while Leatherman asserted that, because Cooper had distributed thousands of pieces of promotional material containing the photo of the altered PST, the applicable penalty was in the tens of millions of dollars. The Supreme Court expressed skepticism regarding Leatherman's effort to inflate the comparable fine, stating that the Ninth Circuit's understanding of Cooper's conduct "is more consistent with the single-violation theory than with the notion that the statutory violation would have been sanctioned with a multimillion dollar fine"<sup>14</sup> and observing more generally that the district court's implicit conclusion that any of the three guideposts supported the jury's verdict was "questionable."<sup>15</sup>

*Cooper* thus supports the defense-side argument that, in applying the third *BMW* guidepost, reviewing courts must focus on what the defendant could realistically have expected to be punished for its conduct, not on the maximum penalties that theoretically could have been imposed had the defendant been found guilty of a criminal conspiracy.

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<sup>14</sup> *Id.* at 1689.

<sup>15</sup> *Id.* at 1688.

## The Role of Profits

Plaintiffs in punitive damages cases often urge juries to disgorge the defendants' profits from their wrongful conduct and then go on to present an inflated number that includes both profits from the alleged misconduct and profits from conduct that was perfectly legal. *Cooper* can be helpful in resisting this kind of argument. In *Cooper*, the Court deemed it "unrealistic to assume that all of Cooper's sales of the ToolZall would have been attributable to its misconduct in using a photograph of a modified PST in its initial advertising materials."<sup>16</sup> In casting doubt on the profits figure urged by Leatherman, the Court made it clear that reviewing courts may not engage in unrealistic assumptions in order to uphold disproportionate penalties.

## The Role of the Defendant's Financial Condition

Anyone who has litigated a punitive damages case is aware that the wealth of the defendant is often a principal determinant of the size of the award. Yet in *BMW*, the Supreme Court did not include wealth in its list of guideposts, even though the plaintiff argued that the \$2 million punitive award at issue could be justified on that basis.<sup>17</sup> To the contrary, it stated: "The fact that BMW is a large corporation rather than an impecunious individual does not diminish its entitlement to fair notice of the demands that the several States impose on the conduct of its business."<sup>18</sup> Since that time, the lower courts have divided as to whether a punitive award that is excessive under the three *BMW* factors

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<sup>16</sup> *Id.*

<sup>17</sup> See Brief of Respondent at 39, *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996) (No. 94-896).

<sup>18</sup> *BMW*, 517 U.S. at 585.

may nonetheless be upheld because the defendant is wealthy. Although *Cooper*, like *BMW* does not squarely decide the issue, like *BMW* it provides strong basis for an argument that an award that is otherwise excessive under the *BMW* guideposts cannot be salvaged by reliance on the defendant's financial condition.

In *Cooper* the net worth of the defendant was an indispensable component of both the district court's conclusion that the punitive award was not unconstitutionally excessive and the Ninth Circuit's determination that, in upholding the punitive award, the district court had not abused its discretion.<sup>19</sup> Notwithstanding the central role played by Cooper's net worth in the lower courts, the Supreme Court gave no indication that a defendant's substantial financial condition is a valid consideration in evaluating a punitive award for excessiveness under the Due Process Clause. To the contrary, throughout the opinion, the Court treated the three *BMW* guideposts as the *exclusive* factors for determining whether a punitive award is unconstitutionally excessive.

For example, in the course of explaining why review of the trial court's excessiveness determination should be *de novo*, the Court observed that, "in deciding whether [the constitutional] line has been crossed, we have

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<sup>19</sup> See *Leatherman Tool Group, Inc. v. Cooper Indus., Inc.*, 1999 WL 1216844, at \*1 (9th Cir. Dec. 17, 1999) ("The district court specifically found that the punitive damage award was proportional and fair, given the nature of the conduct, the evidence of intentional passing off, and the size of an award necessary to create deterrence *to an entity of Cooper's size and assets*. Those findings were supported by the evidence, such that the award did not violate Cooper's due process rights.") (emphasis added).

focused on *the same* general criteria: the degree of the defendant's reprehensibility or culpability; the relationship between the penalty and the harm to the victim caused by the defendant's actions; and the sanctions imposed in other cases for comparable misconduct."<sup>20</sup> Later, when explaining why trial courts enjoy no institutional advantage over appellate courts that would justify deferential review, the Court stated: "In [*BMW*], we instructed courts evaluating a punitive damages award's consistency with due process to consider *three* criteria: (1) the degree of reprehensibility of the defendant's misconduct, (2) the disparity between the harm (or potential harm) suffered by the plaintiff and the punitive damages award, and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases."<sup>21</sup> And finally, in concluding that a remand was necessary, the Court stated: "our own consideration of each of the *three* [*BMW*] factors reveals a series of questionable conclusions by the District Court that may not survive *de novo* review."<sup>22</sup>

The fact that the Court treated the three *BMW* factors as exclusive, notwithstanding the lower courts' heavy reliance on Cooper's financial condition, can be taken as a signal from the Court that punitive damages may not be pegged to wealth.

### When Is Deference Appropriate?

Although *Cooper*'s principal holding is that a district court's ultimate determination of the excessiveness issue must be reviewed *de novo*, the Supreme Court did indicate that deference is required at two precedent phases

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<sup>20</sup> 121 S. Ct. at 1684-85 (citations omitted).

<sup>21</sup> *Id.* at 1687 (emphasis added).

<sup>22</sup> *Id.* at 1688 (emphasis added).

of the analysis. First, the Court observed that neither the trial court nor the appellate court is free to disregard “specific findings of fact” rendered by the jury<sup>23</sup> (unless, of course, the court finds there to be insufficient evidence to support the finding under the JMOL standard). Second, the Court indicated that courts of appeals must defer to any findings of fact made by the district court unless it concludes that those findings are clearly erroneous.<sup>24</sup>

Of course, in the absence of special interrogatories, the only “specific findings of fact” that a jury that has awarded punitive damages can be said to have rendered is that each of the elements of the underlying cause of action was proven and that the defendant had the mental state necessary for the imposition of punitive damages under the applicable law. For example, it cannot be said that the jury specifically found that the conduct at issue was part of a broader pattern of misconduct, that the defendant was a recidivist, or that the potential harm was far greater than the harm that actually befell the plaintiff simply because the jury returned a multi-million dollar punitive award. For all anyone knows, the jury could have thought the conduct to be on the low end of the reprehensibility scale and its punishment to be modest in light of the high net worth numbers paraded before it by the plaintiff. Indeed, I have been involved in two cases in which jurors have indicated that very thing during post-verdict interviews. Accordingly, if plaintiffs desire to take advantage of this aspect of the Court’s opinion, they would be well advised to request special interrogatories.

The analysis is somewhat different with regard to factual findings of the trial court. Typically, federal district courts (and often state trial courts) do draft opinions ex-

plaining their reasons for concluding that a punitive award is or is not excessive. Those opinions often will contain the trial court’s views on what the evidence showed. But not everything in the opinion will constitute a finding of “fact.” Courts of appeals will need to sort out what statements of district courts are truly findings of fact and what are really legal conclusions. Only the former are entitled to deference. For example, a statement that the potential harm to the plaintiff ranged from \$1 million to \$5 million would be the kind of factual finding to which an appellate court would be expected to defer. On the other hand, a statement that insurers that engage in a pattern of bad-faith claims handling could lose their authority to operate in the state and that the most analogous legislatively established penalty for bad faith is therefore in the tens or hundreds of millions of dollars is more in the nature of a legal conclusion as to which no deference is appropriate.<sup>25</sup>

### Conclusion

The significance of *Cooper* extends well beyond the narrow standard-of-review issue actually decided by the Court. Many of the statements it made along the way provide insight as to how it perceives broader punitive damages issues, such as the application of the *BMW* guideposts and the role of corporate financial condition. Whether the Court will soon return to the area of punitive damages remains to be seen, but in the meantime *Cooper* should provide much grist for both lawyers and lower court judges.

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<sup>23</sup> *Id.* at 1687 n.12.

<sup>24</sup> *Id.* at 1688 n.14.

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<sup>25</sup> *See id.* at 1688.