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Trademark Licensor Held Not Liable to Indemnify Because It Did Not Substantially Participate in the Production, Marketing, or Distribution of Defective Product

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Borste raised the affirmative defense of mental illness, contending that her credit card use was not fraudulent because it was an uncontrollable manifestation of her obsessive-compulsive disorder ("O.C.D."). Consequently, she claimed, she was unable to formulate the intent required to establish fraud.

An Objective Test for Intent

The parties agreed that Nordstrom need not show Borste's subjective intent to deceive. Rather, Nordstrom would have to prove that Borste exhibited a reckless disregard for her inability to pay by continuing to charge items to her account when she knew or should have known that she would be unable to pay for the charges. The Ninth Circuit had defined this objective standard in *In re Dougherty,* 84 Bankr. 653 (Bankr. 9th Cir. 1988). The *Dougherty* court had developed a list of the factors to be used to determine a debtor's intent and to determine whether a debtor's credit obligations could be discharged. The factors considered included: the sophistication and financial condition of the debtor, the nature of the debtor's buying habits, whether the debtor had consulted an attorney, and the frequency, timing, and amount of charges.

Applying the *Dougherty* factors, the *Borste* court found that the number of charges, thirty-six at Nordstrom and ninety-two in total, and the nature of them, most charges made for luxury items, were proof of Borste's reckless disregard of her ability to pay when considered in light of her financial resources. Borste's net income of $1,500 to $1,600 per month was objectively insufficient, according to the court, to meet her growing financial obligation to her creditors. At the time of filing for bankruptcy, Borste owed almost $30,000 to her consumer creditors alone. Borste's familiarity with credit transactions, knowledge of bankruptcy as an option while she continued to charge, and sudden and substantial increase in the number of charges before filing demonstrated that she had or should have had an understanding of her inability to pay. Such an understanding constituted intent under the law. The court concluded that Borste incurred the charges with no intent to pay or in reckless disregard of her inability to do so.

The Defense of Mental Illness

The court noted that a debtor may rebut a showing of intent in an action to discharge debt by proving mental incapacity; however, this defense failed because the objective standard was so stringent. Borste's therapist testified that her O.C.D. manifested itself not in a lack of comprehension, but in depression and an inability to control spending. Borste argued that such manifestations of her O.C.D. took away her ability to devise intent. The court found immaterial Borste's subjective knowledge that she could not meet the obligations owed. The court asked instead whether Borste's O.C.D. rendered her unable to understand the consequences of her actions and found that it did not.

The court distinguished Borste's condition from that of the debtor in *In re Fontenot,* 89 Bankr. 575 (Bankr. W.D. La. 1988). In that case, the debtor successfully argued that his severe manic depression could rebut a showing of a debtor's fraudulent intent in a similar action for discharge of debt. In *Fontenot,* the court found the debtor's mental illness was the direct cause of both his spending behavior and his unreasonable belief in his ability to pay his increasing financial obligations. In contrast, Borste's belief that she would be able to pay was based on her past experience, not on her illness. She had testified that she thought of her resources not in terms of her salary but in terms of her previous ability to pay, which often depended on her success in obtaining more credit. The court rejected Borste's defense of O.C.D. because Borste failed to prove that she lacked control of her conduct, let alone that she was beyond understanding the consequences of her behavior.

Credit Card Debt Was Not Dischargeable

The court expressed sympathy toward Borste but stopped short of relieving her of responsibility for her behavior. The court concluded that Borste's conduct showed a reckless disregard for the seriousness of her obligations. After Borste knew or should have known that she lacked the ability to pay, she continued to incur numerous charges for luxury items on her Nordstrom and other accounts. Consequently, Borste's debt to Nordstrom was not dischargeable in bankruptcy.

Frank J. Troppe

Trademark Licensor Held Not Liable To Indemnify Because It Did Not Substantially Participate In The Production, Marketing, Or Distribution Of Defective Product

In ***Burkert v. Petrol Plus of Naugatuck, Inc.,*** 216 Conn. 65, 579 A.2d 26 (1990), the Supreme Court of Connecticut examined whether a distributor of a defective product was entitled to indemnification by the licensor of the trademark under which the defective product was marketed. The court determined that the distributor was not entitled to indemnification because the trademark licensor did not participate in the production, marketing, or distribution of the product.

Factual Background

General Motors Corporation ("GM") was the trademark licensor of Dexron II, a type of automatic transmission fluid. Through a licensing program, GM permitted authorized third parties to use the Dexron II trademark on transmission fluids meeting GM performance standards. GM did not control the actual contents of the transmission fluids meeting GM's performance standards. The contents of transmission fluids produced by GM's licensees were trade secrets to which GM had no access. Furthermore, GM received no royalties or other financial benefits from the licensing program.

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Trademark Licensor

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The aim of the program was quality control rather than marketing the Dexron II product.

Petrol Plus of Naugatuck, Inc. ("Petrol Plus"), a petroleum products distributor, sold automatic transmission fluid to automatic transmission repair shops. Beginning in 1981, Petrol Plus obtained its supply of Dexron II from Atlantic Coast Oil Company ("Atlantic Coast"). Atlantic Coast, a GM licensee, purchased its supply of transmission fluid from an "original formulator" which developed and produced its own proprietary automatic transmission fluid to which Atlantic Coast attached the Dexron II trademark.

In 1983, a customer complained to Petrol Plus about the color of the Dexron II. After receiving numerous customer complaints, Petrol Plus suspended distribution of the bulk transmission fluid in August 1983. Petrol Plus informed its customers that they should stop using the product. Petrol Plus later learned that Atlantic Coast had supplied it with a Dexron II look alike, a base oil dyed red.

Procedural Background

Retail purchasers of the Petrol Plus oil initiated this action against Petrol Plus to recover for damages caused by the defective automatic transmission fluid. Petrol Plus filed third party complaints against Atlantic Coast and GM, seeking indemnification for the settlement expenses with respect to the retail purchasers. The first party action settled. The third party claims were tried to a jury. The Superior Court for the Judicial District of New Haven entered judgment in favor of GM and against Atlantic Coast. Petrol Plus appealed the judgment in favor of GM. The Supreme Court of Connecticut transferred the case to its docket and affirmed the judgment of the trial court.

The Connecticut Supreme Court's Decision

On appeal before the Supreme Court of Connecticut, Petrol Plus argued that the trial court should have held, as a matter of law, that GM was a "product seller" for purposes of the Products Liability Act ("PLA"), Conn. Gen. Stat. § 52-572m(a) (1985), and therefore was liable for indemnification to Petrol Plus under the PLA. Second, Petrol Plus contended that the court gave unnecessarily limited instruction on Petrol Plus's common law theories of indemnity. Third, Petrol Plus argued that the court erred in refusing to charge the jury on Petrol Plus's Connecticut Unfair Trade Practices Act ("CUTPA"), Conn. Gen. Stat. § 42-110b (1985), claim against GM. Petrol Plus lost all three challenges.

Products Liability Act

The PLA, Conn. Gen. Stat. § 52-572m(a) (1985), defined a product seller as "any person or entity including a manufacturer, wholesaler, distributor or retailer who is engaged in the business of selling such products whether the sale is for resale or for use or consumption." The Connecticut Supreme Court held that GM did not fall within the definition of a product seller. First, GM did not produce or sell the product. Second, GM merely allowed others to use its Dexron II trademark. Third, GM was not compensated in any way. The Connecticut Supreme Court stated that without additional participation in the stream of commerce, a trademark licensor was not a product seller under the PLA. Thus, the court affirmed the trial court's decision and held that GM was not a product seller and therefore Petrol Plus was not entitled to indemnification. However, the court also held that the PLA did not prevent Petrol Plus from asserting its common law indemnification claims against GM, as an entity not fitting the definition of product seller.

Common Law Theories

The Connecticut Supreme Court stated that in order for Petrol Plus to recover from GM at common law, Petrol Plus must present a theory of liability that would support an indemnification award against GM. Petrol Plus asserted three separate theories of recovery. First, Petrol Plus argued that under the Lanham Trade-Mark Act, 15 U.S.C.A. § 1064(5)(A) (West 1963 & Supp. 1991), GM had an affirmative duty to supervise its licensees' production and distribution of Dexron II transmission fluid in order to ensure the quality of the product. Petrol Plus contended that GM's lack of oversight demonstrated its negligence.

The court found that the case law cited by Petrol Plus did not suggest that a trademark owner's failure to exercise control would subject the owner to tortious liability for damages caused by a defective product bearing its trademark. The court noted that the concept that a licensor must exercise control over its licensees only applied in cases of trademark abandonment. The court found that Petrol Plus did not show that GM's actions or inaction were the active and primary cause of the damages, as required for proof of negligence. Since GM did not affirmatively exercise control over its licensees, Petrol Plus had no grounds for indemnification.

Second, Petrol Plus argued that GM, as an "apparent manufacturer," was so involved in the stream of commerce that it should be held liable under theories of negligence and strict liability. Petrol Plus contended that GM, through its licensing program, should be treated as the manufacturer of Dexron II; by permitting others to use its trademark, GM placed Dexron II in the market as its own product.

The Connecticut Supreme Court held that liability under the apparent manufacturer doctrine required that a licensor have taken a significant part in the manufacturing, marketing, or distribution of the defective product. GM had no involvement with the defective Dexron II transmission fluid, other than the leasing of the trademark. Thus, GM had not met the threshold involvement level. GM was not liable to indemnify Petrol Plus under strict tort liability and negligence claims based on the apparent manufacturer doctrine.

Third, Petrol Plus argued that GM was liable for breaches of implied warranties of merchant-ability and fitness for a particular purpose and for breach of an express warranty. Under the Connecticut Uniform Commercial Code ("UCC"), a party may only recover breach of warranty damages against a seller or a merchant. Conn. Gen. Stat. §§ 42a-2-313 - 2-315 (1985). The Connecticut UCC defined a seller as a "person who sells or contracts to sell goods." Conn. Gen. Stat. §§ 42a-2-103(1)(d) (1985). The court previously held that GM was not in the business of selling Dexron II. Thus, the court concluded that Petrol Plus could not recover under the UCC warranty provisions, since GM, by definition, was not a "seller."

Petrol Plus also argued it should receive indemnification based on the common law theory of warranty. However, the court determined that a party would have to establish significant involvement in the stream of commerce to recover under this theory. The court found that Petrol Plus did not prove this threshold participation by GM. The court thus rejected Petrol Plus's indemnification claim based on a common law warranty theory.

Connecticut Unfair Trade Practices Act

CUTPA, Conn. Gen. Stat. § 42-110b(a) (1985), provides that "no person shall engage in unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." In its definition of trade or commerce, the statute includes advertising, selling, and distributing goods. Once again, the court held that GM did not fit the statutory definition. GM did not advertise the Dexron II transmission fluid nor did it sell or distribute the defective transmission fluid. Thus, the Connecticut Supreme Court affirmed the trial court's refusal to charge the jury with respect to Petrol Plus's CUTPA claim.

Suzanne Kuzmenka

Investors Who Relied On Tax Opinions May Not Recover Back Taxes And Interest Paid For Disallowed Deductions

In *Alpert v. Shea Gould Climenko & Casey,* 559 N.Y.S.2d 312 (1990), the Supreme Court of New York, Appellate Division denied recovery to investors of back taxes and interest which they were required to pay to the Internal Revenue Service after the deductions they took were disallowed. The investors had relied on the opinions of two law firms and invested in a coal mining tax shelter. In addition, the court held that the investors could not amend their complaints to assert additional claims for fraud and breach of fiduciary duty.

Background

On December 16, 1977, the United States Treasury Department ("Treasury") amended one of its regulations to disallow deductions from gross income for advance minimum royalty payments in connection with mineral properties. Treas. Reg. § 1.612-3(b)(3) (1977). An advance minimum royalty is a fixed amount of money to be paid to the owner of mineral property before mining begins, as opposed to periodic royalty payments made in proportion to the amount of minerals mined. Three days later, the Internal Revenue Service ("I.R.S.") revised a revenue ruling to provide that taxpayers may not take an immediate deduction for the full amount of the advance minimum royalty payment but must take deductions for such payments only in the year in which the corresponding minerals are extracted. Rev. Rul. 77-489, 1977 I.R.B. 51.

Prior to these Treasury and I.R.S. releases, Esanu, Katsky and Korins (the "Esanu firm"), a law firm, had structured Logan Properties Program ("Logan"), a coal mining business. Logan appeared to provide investors an opportunity for immediate deduction of an advance minimum royalty to be paid by Logan. By December 21, 1977, following publication of the government releases, the Esanu firm withdrew its opinion with respect to the Logan investment program. The Esanu firm advised the operating manager of Logan that while there was a basis in law for taxpayers to deduct Logan's advance minimum royalty payment, there was also a significant chance that the I.R.S. would disallow such a deduction in part or in full.

Logan then asked Shea Gould Climenko and Casey ("Shea Gould") for an opinion letter to be included in its promotion materials. On December 20, 1977, Shea Gould opined that there was a reasonable basis for concluding that the revenue ruling was invalid. However, Shea Gould advised that taxpayers who invested in Logan might, nevertheless, would be unable to deduct the advance minimum royalty payment immediately upon investing in Logan if the I.R.S. successfully applied the distortion of income concept.

On December 30, 1977, George Alpert ("Alpert") and Lee Wolfman ("Wolfman") each invested $52,500 in Logan. Alpert and Wolfman based these investment decisions on the tax opinions of the Esanu firm and Shea Gould. On their 1977 tax returns, Alpert and Wolfman each deducted $ 216,645 for advance minimum royalty payments for the right to mine coal. On their 1978 returns, each deducted $10,893 for the advance minimum royalty payments. In 1984 and 1985, the I.R.S. disallowed the deductions taken by Alpert and Wolfman in 1977 and 1978. Alpert and Wolfman had to pay the tax deficiencies plus interest.

In 1984, Alpert and Wolfman each commenced actions against the advising law firms for fraudulent misrepresentation. In the lawsuits, Alpert and Wolfman sought lost profits and recovery of the tax benefits they would have received if they had not relied on the opinions of the Esanu firm and Shea Gould and had instead invested in a viable tax shelter. Alpert and Wolfman

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