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Bankruptcy Court Holds Debtor Responsible for Obsessive-Compulsive Use of Credit Card

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Exclusive Warranties

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ing the Eb/1624 machines. Finally, the court rejected K & T's breach of contract counterclaim against Ragen.

The Third Circuit's Opinion

The Third Circuit reversed the lower court's holding that Wisconsin state law denied Ragen consequential damages. The court concluded that the exclusive limited warranties which failed in their essential purpose, allowed recovery for consequential damages, even if the contract excluded such consequential damages. Because K & T, after extensive effort, could not repair or replace the machines to make them perform as warranted, K & T's exclusive warranty failed in its essential purpose. Therefore, the court reversed the district court's decision that Ragen was not entitled to recover consequential damages, despite explicit exclusion of such damages in the warranty. The court remanded the issue of consequential damages for retrial.

The Third Circuit then reviewed the district court's decision to award Ragen direct damages. The court stated that in order for Ragen to recover direct damages, Ragen must present evidence of losses, on which a reasonable assessment of damages may be based. The court reasoned that this required Ragen to produce evidence showing the actual value of the MM800 units it received and the value of the units as warranted. Ragen, however, only submitted evidence on (1) the purchase price of the MM800, (2) the average up-time of the machines, and (3) the average up-time of similar machines in the industry. The court decided that this evidence was insufficient to prove adequately the actual value of the MM800. Therefore, the court held that Ragen was not entitled to direct damages and accordingly reversed the district court's decision.

Next, the Third Circuit examined the lower court's rejection of K & T's counterclaim against Ragen for damages allegedly arising

from Ragen's cancellation of orders for new machines. The court decided that the issue required application of section 2-708(2), UCC § 2-708(2) (1989), commonly referred to as the "lost volume seller" provision. Section 2-708(2) provides that a seller may recover lost profits in the event the standard measure of damages is inadequate. The court defined a lost volume seller as one who could have sold an item to both the breaching buyer and a subsequent buyer; the seller, having made essentially only one rather than two sales, suffered damage which could only be remedied by an award for the amount of lost profits.

The Third Circuit noted that the fundamental question in applying the lost volume seller provision was whether the seller had the ability to provide the item to the breaching buyer as well as to the resale buyer. The court found that, based on testimony of the case, K & T, at the time Ragen cancelled the orders, had more orders for machines than it could fill. Thus, the court concluded that K & T could not have simultaneously supplied both Ragen and another buyer; K & T was not a "lost volume seller." Thus, the court held that K & T was not entitled to damages and affirmed the district court's decision.

Finally, the Third Circuit reviewed the district court's decision on the Eb/1624 retrofitted machines. The court found that the district court did not refer to the Eb/1624s. Instead, the district court had discussed a retrofitted MM200, a machine not involved in the case. Although the court suspected the district court simply misnamed the Eb/1624s, it remanded this issue for clarification. Additionally, since the district court did not rule on Ragen's fraud claims, the Third Circuit remanded this issue as well.

Richard E. Nawracaj

Bankruptcy Court Holds Debtor Responsible For Obsessive-Compulsive Use of Credit Card

In *In re Borste*, 117 Bankr. 995 (Bankr. W.D. Wash. 1990), the United States Bankruptcy Court for the Western District of Washington held that a debtor's credit card debts were not dischargeable in bankruptcy even though the debtor had incurred the obligations while suffering from an obsessive-compulsive disorder which affected her ability to control her credit card spending.

Background

Cathy Borste ("Borste"), the debtor, was a machinist at the University of Washington. She earned approximately \$26,000 annually. Borste used a combination of seven credit cards to make at least ninety-two charges from May through August 1989, the majority of which were for luxury items. Prior to this period, Borste had difficulty controlling her spending and meeting her resulting financial obligations. In May 1989, Borste owed about \$24,000 in secured and unsecured debt. In June 1989, Borste sought credit counseling but was refused assistance. During credit counseling, however, Borste had learned that she could declare personal bankruptcy.

Borste shopped extensively in the following months. She also travelled to Europe in early September and returned in mid-October. Upon her return, she consulted an attorney and filed a Chapter 7 petition on November 7, 1989. Borste owed over \$43,000 to her creditors at the time she filed for bankruptcy.

Nordstrom, Inc. ("Nordstrom"), a creditor, filed a complaint alleging that thirty-six of the charges made to Borste's Nordstrom account were not dischargeable. Nordstrom argued that these charges fell within the Bankruptcy Code, 11 U.S.C. § 523 (a)(2)(A) (1979), because Borste made them with no intention of paying them. Thus, the charges had been incurred through fraud, making them not dischargeable.

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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