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Toward a Trademark-Based Liability System

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TOWARD A TRADEMARK-BASED LIABILITY SYSTEM

Lynn M. LoPucki

Under current law, trademark owners are not liable for the products sold, or the wrongful acts of businesses conducted, under the trademarks. This Article proposes the imposition of such liability. The rationale for the change is that product and other liability of businesses to customers is part of the customer’s calculus in choosing a seller. In making their choices, customers rely upon the only information available in the marketplace—trademarks. The entity structures of businesses (corporate groups, franchises, joint ventures, and the like) are generally invisible to customers. Yet under current law, businesses’ liabilities to customers are calculated from those entity structures. The result is a failure in the market for liability and in the operation of the liability system: Customers lack the information they need to contract for the level of supplier financial responsibility they prefer.

The proposed rule would create no new liability. It would merely extend existing liability to trademark owners. The rule would extend liability to trademark owners for (1) defective products sold under the mark and (2) the wrongful acts of licensees that conduct businesses identified to customers by the mark. The initial assignment of liability to the trademark owner will make it more difficult for businesses to externalize their liabilities. Trademark owners will remain free, however, to reallocate the liability to their licensees by contracts requiring indemnification or insurance.

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INTRODUCTION

Large businesses are seldom owned and operated by a single legal entity. Most are complex arrays of entities. A typical array may be composed of thirty or forty corporations and limited liability companies that are members of a corporate group, together with the group members' franchisees, partners (legally or merely figuratively), joint venturers, and numerous other kinds of affiliates. Liability incurred by such an array attaches to one or more of the array's entities. The entity or entities charged are selected through the application of complex attribution rules to an entity structure that the array-members or their attorneys created. For example, if the business is conducted under the famous trademark of the parent company, but the employee tortfeasor is employed by an obscure subsidiary, the employee will be liable and respondeat superior will transmit that liability only to the subsidiary.

Customers of such an array rarely understand its entity structure. We know them only by their trademarks and trade names. We pull into a Mobil station for gas, we buy a Honeywell keyboard, and we have confidence in the integrity of the Academy Awards vote count because Price Waterhouse certifies the results.

If litigation ensues, however, we are often disappointed to learn that, in the eyes of the law, the icons on which we relied do not exist. That is, liability law recognizes no entity or actor corresponding to Mobil, Honeywell, or Price Waterhouse. We did not pull into a Mobil station; we pulled into an independent station licensed to display Mobil trademarks. Honeywell neither manufactured nor sold the "Honeywell" keyboard we bought; a subsidiary in

1. I have invented the term "array" out of necessity. "Corporate group" is a narrower concept that includes only those entities affiliated through common ownership.
2. For example, thousands of "independent" franchisees operate gasoline service stations under the Mobil name and hundreds of independent partnerships do business as "Price Waterhouse." See, e.g., Mark A. Lemley, The Modern Lanham Act and the Death of Common Sense, 108 YALE L.J. 1687, 1691 (1999) ("[T]he general acceptance today of the principle that trademarks can be licensed to others, at least under some circumstances, reflects a world in which the production of goods is less tied to a particular corporate structure than ever before.").
3. The property of a corporate group or array is owned not by the group or array, but by its members. A plaintiff cannot sue a group, but only members of a group. When a plaintiff sues members of a group, the law will calculate the liability of each accused group member separately, based on the particular member's involvement in the allegedly wrongful act.
the Honeywell group did. Price Waterhouse did not certify the Academy Awards vote count; only one of many accounting firms licensed to use that name did. The immediate effect of these icons' nonexistence will often be to confine legal liability to previously invisible trademark licensees. If those licensees are not financially responsible, the ultimate effect may be to defeat liability altogether.

Even if a product or business identifies itself to the public only by a trademark, the trademark owner may not be liable for the product's defects or the business's wrongful acts. Three recent cases illustrate this phenomenon.

First, in Mobil Oil Corp. v. Bransford, the plaintiff—a college student majoring in music—entered a Mobil Mini Mart gas station where a station employee beat him so severely that he ended up with three metal plates in his head. The employee had a history of assaulting customers. Mobil Oil Corporation, owner of the Mobil trademarks, owned the station. Trademarked Mobil products were sold from the station. Mobil trademarks and logos were used throughout the premises. Employees were required to wear Mobil uniforms, and the employee who beat the plaintiff was wearing a Mobil hat during the incident. The court implicitly assumed that the employee committed the tort in the scope of his employment. But the court nevertheless held Mobil Oil Corporation not liable because the employee worked not for Mobil, but for an "independent businessman" who operated the minimart as a Mobil franchise. Mobil licensed the trademarks and logos to the franchisee. Respondeat superior rendered the franchisee liable for the wrongful act of the franchisee's employee, but no rule transmitted that liability to Mobil Oil Corporation.

Second, in Yoder v. Honeywell Inc., the plaintiff suffered repetitive stress syndrome from use of two defective keyboards marketed under the Honeywell trademark. Even though the keyboards bore no indication of their source except that trademark, the court upheld a summary judgment in favor of Honeywell Inc. Honeywell Inc. neither manufactured nor distributed

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4. 648 So. 2d 119 (Fla. 1995). For another similar case, see Arguello v. Conoco, Inc., 207 F.3d 803 (5th Cir. 2000), which held Conoco, Inc. not liable for racial discrimination by its franchisees. See also Randall K. Hanson, The Franchising Dilemma Continues: Update on Franchisor Liability for Wrongful Acts by Local Franchisees, 20 CAMPBELL L. REV. 91 (1997) (discussing cases). Randall Hanson concludes that "some decisions indicate that typical franchise provisions constitute control and liability while other decisions indicate that typical controls are not sufficient to impose liability." Id. at 112.
5. See Mobil Oil Corp., 648 So. 2d at 120.
6. See id.
7. id.
8. 104 F.3d 1215 (10th Cir. 1997).
9. See id. at 1218.
10. See id. at 1225.
the keyboards. It merely licensed its Honeywell trademark for use on keyboards that Bull HN Information Systems, Inc.—a wholly owned subsidiary of Honeywell Inc.—manufactured and distributed. Hence, the court reasoned, Honeywell Inc. was not liable as a manufacturer or a distributor. Nor was Honeywell Inc. liable as an “apparent manufacturer” because that doctrine can be applied only against an entity that is “in the chain of distribution.”

Third, in Young v. Jones, the plaintiff had lost $550,000 it invested in reliance on an erroneous audit letter. The letter was on “Price Waterhouse letterhead” and gave no other indication of its source. Price Waterhouse Bahamas issued the letter. That firm was licensed to use the Price Waterhouse trademark, but was neither owned nor controlled by the owner of the Price Waterhouse trademark. In the plaintiff’s action against Price Waterhouse U.S., the court held that the mere fact the two partnerships were doing business under the same trademark was not sufficient to render one liable for the wrongful act of the other.

These are not isolated cases. Passive trademark owners are not liable for the wrongful acts of those who do business under their marks. This Article pro-

11. See id. at 1223-24 (declining to hold Honeywell Inc. because it neither sold nor distributed the keyboards).
14. Young, 816 F. Supp. at 1074 (“The letterhead identified the Bahamian accounting firm only as ‘Price Waterhouse.’ The audit letter also bore a Price Waterhouse trademark and was signed ‘Price Waterhouse.’”).
15. The U.S. Court of Appeals for the Fourth Circuit described the relationship in these words: PW-Bahamas is part of a world-wide organization of separate and independent Price Waterhouse firms that practice accountancy in various countries. The members of each Price Waterhouse firm hold shares in Price Waterhouse World Firm Limited (PW-World Firm), a limited liability company incorporated under the laws of Bermuda. PW-World Firm assists the various Price Waterhouse firms in advancing their respective practices, and it facilitates the maintenance of uniform standards of practice. It does not conduct or supervise client engagements, however. Nor does it play a part in the day-to-day management of the Price Waterhouse firms.

Young, 103 F.3d at 1191 n.6.
16. In Young, the court relied on § 16(1) of the Uniform Partnership Act, as adopted in South Carolina. See Young, 103 F.3d at 1192. The substance of that provision has been retained in the Revised Uniform Partnership Act. See R.U.P.A. § 308(a), (b), (e) (1997) (requiring an “existing partnership” to which a purported partner must be represented to belong as a prerequisite to holding persons not partners as to each other liable to third persons). In Young, no actual partnership existed between Price Waterhouse U.S. and Price Waterhouse Bahamas, so no basis would exist for holding Price Waterhouse liable to third parties.
17. See, e.g., Fletcher v. Atex, Inc., 68 F.3d 1451 (2d Cir. 1995) (rejecting four theories under which Kodak was charged with liability for defective computer keyboards manufactured by a Kodak subsidiary and marketed using the Kodak name); David J. Franklyn, Toward a Coherent Theory of
Trademark-Based Liability System

Trademark owners who authorize franchisees, subsidiaries, affiliates, and other licensees to use the owners’ trademarks to identify themselves or their products to customers should be jointly and severally obligated for the licensees’ liabilities to those customers. The reason for imposing this liability on trademark owners is that the relationships through which liability arises are largely contractual. Most customers assume they are dealing with the trademark owner, and even those who realize they are not lack the information necessary to contract meaningfully with the entities that operate behind the trademark’s mask. In short, trademark owner liability is necessary for the largely contractual system of tort liability to work because trademarks are the only information available to most actors in the marketplace.

Courts and commentators have assumed that the entity structures of businesses presumptively provide an appropriate basis for liability. They have brushed the information problem aside by engaging in the legal fiction that customers know the entity structures of the businesses with whom they deal.

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18. The drafters of the Restatement recently rejected trademark owner liability in the products liability context. See RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 14 cmt. d (1998) (stating that the trademark licensor who does not sell or otherwise distribute products is not liable under the Restatement). James Henderson, coreporter for that Restatement, explained that the intent of the provision referred to was not to advocate a position, but merely to recognize the majority view that declines to place liability on trademark owners who neither manufacture nor sell the products involved. See Telephone Interview with James A. Henderson, Jr., Frank B. Ingennoll Professor of Law, Cornell Law School (May 30, 2001).

In the franchising context, Thomas McCarthy, the leading commentator on trademarks, describes the current situation as follows: "In general, it is accurate to conclude that there is a very substantial risk that a trademark licensor or franchisor will be held liable for the torts of licensees and franchisees." 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:74 (4th ed. 2001); see also John L. Hanks, Franchisor Liability for the Torts of Its Franchisees: The Case for Substituting Liability as a Guarantor for the Current Vicarious Liability, 24 OKLA. CITY U. L. REV. 1, 2-3 (1999) ("Unlike most areas of law that are frequently litigated, the law of franchisor liability for the torts of their franchisees remains unsettled, with courts unable to achieve a consensus in their approach.").


20. In one of the cases already discussed, for example, the Supreme Court of Florida stated that "[i]n today's world, it is well understood that the mere use of franchise logos and related advertisements does not necessarily indicate that the franchisor has actual or apparent control over any substantial aspect of the franchisee's business or employment decisions." Mobil Oil Corp. v. Bransford, 648 So. 2d 119, 120 (Fla. 1995) (holding Mobil Oil Corporation not liable for the tort of a Mobil Mini Mart employee). Similar statements abound in the law governing franchisees' liability. See Robert W. Emerson, Franchisees' Liability When Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising, 20 HOFSTRA L. REV. 609, 610-12 (1992) (citing cases). Professor Robert Emerson has demonstrated convincingly that such statements are wrong:

[These courts misread the relative state of "common knowledge," since only 9.9% of the respondents [in a random telephone survey] correctly answered that most Chevron gas stations are locally owned and operated, while 57.0% erroneously believed that they were mostly...
The assumption and fiction have caused those courts and commentators to focus their attention on the actual relationship between the trademark owner and the entity doing business under the mark. The actual relationship, however, is invisible to contracting customers and should therefore be considered irrelevant.

Part I of this Article describes the arcane system that determines who is liable to customers for the wrongful acts of a business. In essence, customers are deemed to accept the liability of the entity doing business under the trademark, not the entity that owns the trademark—even if they have no way of knowing who or what the former entity is. Part II explains the rationale for the proposed liability extension—trademark owners are better able to evaluate the entity structures and financial responsibility of their licensees than are customers. If trademark owners share the liability of their licensees, customers will be able to rely on trademarks in choosing the persons with whom they deal, and trademark owners will have appropriate incentives to exert control over their licensees. Part III defines the scope of the proposed extension by describing the conditions under which the proposed liability should arise. Part IV notes the residual vulnerability of the proposed liability to judgment proofing—strategic action that blocks the enforcement of judgments—but concludes that cultural and political considerations will be sufficient to restrain judgment proofing in this unique context. Part V summarizes the proposal and the reasons for its adoption.

I. THE MARKET FOR LIABILITY

Markets for goods and services operate simultaneously as markets for liability. The selection of a seller or supplier is not only a selection of a product nationally owned and operated, and 28.0% incorrectly concluded that most were dually owned and operated both nationally and locally.

Id. at 653.

21. See Franklyn, supra note 17, at 5-6 (advocating a rule that would impose liability only on “[trademark] licensors who are not mere passive investors but who exert substantial control over their licensees, and who use the licensing arrangement to improperly shield themselves from liability”).

22. With respect to franchisors, two commentators have reached the same conclusion I do: Trademark owners should be liable for the torts of their franchisees. Neither reached that conclusion for the reasons I present here, and neither generalized it to other kinds of trademark owner-licensee relationships. See Hanks, supra note 18, at 8 (advocating that franchisors be held liable as guarantors of the tort liability of their franchisees); Note, Liability of a Franchisor for Acts of the Franchisee, 41 S. CAL. L. REV. 143, 160 (1968) (“The desirability of protecting the third party requires that the franchisor exercise control over the franchisee and the possession of this control generally makes the franchisor the appropriate party to be held liable for harm arising out of the operation of the franchise.”); see also Michael R. Flynn, Note, The Law of Franchisor Vicarious Liability: A Critique, 1993 COLUM. BUS. L. REV. 89, 106-07 (criticizing the uncertainty in current law and presenting three alternative proposals for reform, but declining to choose among them without further study).
or service, but also a contract for legal and financial responsibility in the event that the product or service fails or the customer or third parties are injured at any stage of the relationship. To illustrate, when Janice the carpenter chooses to shop for her lumber at Home Depot, she is choosing the entities that will have legal liability to her or parties claiming through her. That liability might arise because she is injured while shopping, the lumber is not delivered on time, or defects in the lumber cause injuries to her or to third parties. To understand the effect that bundling products or services with liability has on the market for liability, it is first necessary to understand how the liability system works.

A. Liability System Principles

The liability system operates according to a set of principles that are so basic they often go unnoticed. First, with rare exceptions, liability accrues only to legal entities: corporations, partnerships, limited liability companies, individuals, and the like. As the system currently operates, a business cannot be liable. Second, liability is generally enforced only against property, not the entities themselves. Only in rare circumstances can courts order entities to pay debts. The judgment creditor's right is to force the sale of the debtor-entity's property and be paid from the proceeds of sale. Once that source of payment is exhausted, enforcement ends. Third, the property that may be sold is only that of the debtor—the particular entity to which liability accrued. Complex legal rules determine what entity or entities are liable for particular wrongful acts. To continue with the above illustration, if Edgar, an


24. To put the matter another way, to say that something is not an entity is to say that the law will not impose liability on it. See, e.g., State v. Houston Lighting & Power Co., 609 S.W.2d 263, 268 (Tex. App. 1980) (“Neither a partnership nor a joint venture exists in this case. The Project itself is not a legal entity, and is not liable for the assessment or payment of any taxes against any of the properties comprising the Project.”).

25. That is, one cannot obtain a judgment against a business, even if the business is coextensive with the entity. Professor Phillip Blumberg has long argued that the law has increasingly accepted "enterprises"—essentially "businesses"—as the basis for liability. See Phillip I. Blumberg, The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities, 28 CONN. L. REV. 295 (1996). Blumberg's arguments, however, pertain principally to the obligations of regulated enterprises to obey regulatory laws. See id. at 307–12. As to civil liability, Blumberg's examples of "enterprise liability" are merely examples of cases in which courts hold particular entities liable for the debts of other entities in extraordinary circumstances. See, e.g., id. at 326–29 (discussing the bankruptcy doctrines of substantive consolidation, equitable subordination, and fraudulent transfer law as applied to intragroup guaranties). The effect of "enterprise liability" is not to hold businesses liable, but to hold more entities liable.


27. See id.

28. See id. at 9–10.
employee who mops the floors at Home Depot, negligently leaves a puddle of water and Janice is injured when she slips on the water and falls, Edgar will be liable. It is unlikely, however, that Janice will be able to recover any judgment she obtains by forcing a sale of Edgar's property. Even if Edgar owns his own home and automobile, those items of property may be fully encumbered to prior creditors or exempt from execution. If so, Edgar is "judgment proof"—the judgment cannot, as a practical matter, be enforced against him. With respect to substantial judgments at least, nearly all employees are judgment proof.

The liability system is able to operate nevertheless because the law renders additional entities vicariously liable on a variety of theories. Those entities include employers, manufacturers, sellers, entities that delegate the performance of inherently dangerous tasks to independent contractors, and entities that delegate any task to an incompetent contractor.

On the facts of the above illustration, the doctrine of respondeat superior will transmit liability to Edgar's employer. If Edgar's employer is Home Depot,

29. Secured creditors have priority over creditors who later seek to enforce judgments. See HENRY J. BAILEY III & RICHARD B. HAGEDORN, SECURED TRANSACTIONS 366 (4th ed. 2000). The Uniform Commercial Code does not expressly deal with priority between a secured party with a perfected security interest and a creditor who has subsequently obtained a lien on the collateral by attachment, garnishment, levy or the like. However, it is clearly implied that the secured party with a prior perfected interest should prevail over a subsequent lien creditor.

Id. For an explanation of how this priority blocks recovery by the subsequent judgment creditor, see LoPucki, supra note 23, at 14–19, which describes "secured debt strategies" for judgment proofing.


31. Debtors are referred to as "judgment proof" when their assets, if any, are held in forms that render enforcement of judgments against them impossible. See Lynn M. LoPucki, The Essential Structure of Judgment Proofing, 51 STAN. L. REV. 147, 149–56 (1998) (describing the basic structure common to all judgment proofing). Judgment proofing is referred to as "hard" if it "aims at denying all recovery to every plaintiff" and "soft" if it "contemplates payment of judgments in relatively small amounts but discharge of judgments in relatively large amounts." LoPucki, supra note 23, at 46–47.


33. See generally Schwartz, supra note 32 (discussing the rationales for vicarious liability).

34. Delegation to a judgment-proof independent contractor, without more, is not sufficient to render the delegator liable. See Robinson v. Jiffy Executive Limousine Co., 4 F.3d 237, 242–43 (3d Cir. 1993) (holding that the hiring of a "judgment proof" independent contractor was not the hiring of an "incompetent" independent contractor so as to render the person hiring liable).

35. The doctrine of respondeat superior generally makes employers liable for the wrongful acts of their employees committed in the scope of the latter's employment. See generally JAMES A.
Inc., a prosperous corporation that owns hundreds of stores and carries substantial liability insurance, the effect will be to render Janice’s judgment collectible. Even if the insurance company failed to pay, Janice could force sale of sufficient property belonging to the judgment debtor to satisfy the judgment.

If, instead, Edgar were employed by an insolvent franchisee that leased the store, licensed the right to use the Home Depot name, and carried no liability insurance, the effect might be to render Janice’s judgment uncollectible. The entity liable under respondeat superior—the franchisee corporation—might have no unencumbered assets from which Janice could satisfy her judgment. That the entity was judgment proof might mean that it would go out of business, but not necessarily. A judgment-proof entity can discharge its obligations in bankruptcy while continuing to operate its business. When liability accrues only against judgment-proof entities, the effect is much the same as if there had been no liability at all.

The law deliberately offers businesses a variety of devices for limiting liability. “Limited liability” entities, which today include not only corporations but also limited liability companies (LLCs), limited liability partnerships (LLPs), and limited liability limited partnerships (LLLPs), insulate their owners from liability the entities generate. The assets of a single business can be divided among the entities of a “corporate group” so that the entities that generate liability are not the ones that own the assets. Assets that otherwise would be available to satisfy judgments against a member of the group—including one corporation’s stock ownership in another—can be protected by encumbering them. Franchise agreements can block liability by inserting an “independent business” between the seller and the buyer of a product. Leasing property to a tenant who assumes responsibility for the property’s condition relieves the owners of most liability for injuries to third parties on the premises. Provided that the property owners carefully structure


36. See LoPucki, supra note 23, at 17–18.
37. One difference is that the victim may derive some satisfaction from winning a judgment despite his or her inability to collect. Another is that the owners of the tortfeasor entities may be inconvenienced by the “failure” of their business. Upon failure, one or more secured creditors initially may control the assets, but if the former owners wish to resume their ownership (subject to the secured debt) the former owners may be able to reacquire control by striking a bargain with the secured creditors. See LoPucki, supra note 31, at 154–55 (explaining the economic forces that will reunite the business with its former owners).
38. See LoPucki, supra note 23, at 20–23.
39. See id. at 14–18 (explaining how encumbrances protect assets from other creditors).
40. See supra note 4 and accompanying text.
41. See, e.g., Johnson v. Loy, 499 S.E.2d 140 (Ga. Ct. App. 1998) (holding that an owner-landlord who has fully parted with possession and the right to possession is not liable for damages resulting from the negligence of the tenant); Evans v. United Bank of Ill., 589 N.E.2d 933, 936
their relationships with the managers, the property owners need not risk even the capital they have invested.\textsuperscript{42}

This Article refers to the particular combination of liability-limiting devices employed by a business as the "entity structure" of the business. To illustrate the concept, at the time Jeremy Bransford walked into the Mobil Mini Mart to meet his fate, Mobil Oil Corporation was one of ten subsidiaries of Mobil Corporation.\textsuperscript{43} Mobil Oil Corporation in turn had eighteen subsidiaries, some of which had their own subsidiaries.\textsuperscript{44} The entire corporate group—known as "Mobil" or "Mobil Oil"—consisted of about 100 corporations\textsuperscript{45} with assets totaling about $41 billion.\textsuperscript{46} Each of the assets comprising that total value was owned by some member of the corporate group. Some members may have owned substantial assets, others may have owned no assets at all. From the public record, it is impossible to tell what portion of the $41 billion in assets any particular entity owned. The stock of most members of the group was owned entirely by other members of the group, but some of the stock of some members of the group was owned by outsiders.\textsuperscript{47}

One can tell from the public record that Mobil Oil Corporation—the entity Bransford sued—owned most of Mobil's U.S. trademarks, including the ones displayed on Mobil Mini Marts.\textsuperscript{48} Mobil Oil Corporation also owned the land and building occupied by the Mobil Mini Mart.\textsuperscript{49} Mobil Oil Corporation contracted with an "independent businessman" as franchisee to operate the Mobil Mini Mart where Bransford was beaten.\textsuperscript{50} The independent
businessman leased the land, licensed the trademarks from Mobil Oil Corporation, and agreed that he would "render prompt, fair, courteous, and efficient service to . . . customers."51

In Mobil Oil Corp. v. Bransford, the plaintiff had urged the court to transmit liability from the franchisee to Mobil Oil Corporation on an "apparent agency" theory. That theory required a "representation by [Mobil Oil Corporation]" that Mobil Oil Corporation "was exercising substantial control" over the operation of the Mobil Mini Mart.52 The court held that the mere use of trademarks was not such a representation.53

Had Bransford prevailed on that argument, liability would have reached Mobil Oil Corporation, a member of the Mobil corporate group. The group—which results from the division of ownership of Mobil's business among numerous entities—is itself an entity structure created in large part to limit or defeat liability.54 For example, had Mobil Oil Corporation fully encumbered the trademarks and leased the other assets it used in its business rather than owning them, Bransford could not have recovered from those assets. But in that event, he might have invoked various other legal doctrines—such as "piercing the corporate veil" or "enterprise liability"—in an attempt to transmit the liability to other members of the Mobil group.55 If he succeeded, he might have recovered from the assets owned by those members.

Lawyers for potential defendants deploy entity structures—set up subsidiaries, write leases and licenses, and otherwise isolate assets to protect them from anticipated liabilities—before liabilities come into existence.56 Courts

51. Id. at 123.
52. Id. at 121.
53. See id.
54. See Lynn M. LoPucki, Virtual Judgment Proofing: A Rejoinder, 107 YALE L.J. 1413, 1427 (1998) (arguing that "[limiting liability is widely understood to be the principal reason for the separate incorporation of subsidiaries"). But see White, supra note 32, at 1388-91 (arguing that corporations have other reasons for incorporating subsidiaries).
55. In particular circumstances, the courts are authorized to disregard specific aspects of the entity structure by "piercing the veil" of a limited liability entity or consolidating the debts and assets of two or more entities. See, e.g., ROBERT W. HAMILTON, BUSINESS ORGANIZATIONS 315-31 (1996) (describing the legal doctrines); Stephen M. Bainbridge, Abolishing Veil Piercing, 26 J. CORP. L. 479 (2001) (same). In practice, however, such disregard is rare. See Robert B. Thompson, Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors, 13 CONN. J. INT'L L. 379, 385-88 (1999) (showing that despite judicial rhetoric to the contrary, piercing the corporate veil within a corporate group on behalf of a tort plaintiff is extremely rare).
56. Numerous books have been written on, and entire journals devoted to, the topic of "asset protection planning." See, e.g., DUNCAN E. OSBORNE, ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS (1995) (providing a four-volume practice guide). Professor Elena Marty-Nelson notes that "many experienced practitioners in the area regard complex asset protection strategies—with their nearly impenetrable protections for the assets of wealthy clients—as the perfect antidote to the unpredictability of a tort litigation system run amok." Elena Marty-Nelson, Domestic and International Asset Protection Planning, 45 CATH. U. L. REV. 1269, 1269 (1996).
treat those entity structures as the presumptive starting points for calculating the reach of liability. Lawyers for plaintiffs then seek to persuade the courts to pierce deeply enough into the entity structures to reach assets sufficient to satisfy the liabilities. In that effort they employ doctrines such as apparent agency, apparent manufacturer, and enterprise theory that may, in particular circumstances, transmit liability to a trademark owner. But, the mere status of the trademark owner as such is an insufficient basis on which to impose liability. Use of the trademark to identify the tortfeasor’s product or business is merely one of several factors that determine the trademark owner’s liability under current law. Thus, the extent of enforceable legal liability is the product of a complex, problematic strategy game.

In *Mobil Oil Corp. v. Bransford*, the court concluded that liability attached to the employee who beat Bransford and was transmitted to the franchisee by operation of the doctrine of respondeat superior. There the liability stopped. The plaintiff could reach assets owned by, and insurance provided to, the employee or the franchisee, subject to other limitations such as laws exempting assets from legal process or granting priority to secured creditors. But if neither of the liable defendants had nonexempt, unencumbered assets, the court was saying Bransford should not recover at all.

**B. “Contracting” for Liability**

The three cases with which this Article began illustrate the contractual underpinnings of businesses’ “tort” liability to their customers. When a customer

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Although some egregious instances of corporate judgment proofing inevitably come to light, see, e.g., infra note 156 (discussing Pacific Gas & Electric), systematically documenting the deliberate use of these devices to defeat tort liability is a dauntingly difficult task. Most of the necessary information is secret. See, e.g., LoPucki, supra note 54, at 1416–17 (explaining the lack of public data on the holdings of individual members of corporate groups). That judgment proofing is not occurring, however, is simply implausible because such large amounts of money are at stake. See id. at 1413 (listing U.S. companies that suffered huge tort losses).


58. See, e.g., *Affiliated FM Ins. Co. v. Trans Co.*, 831 F.2d 153, 155 (7th Cir. 1987) (recognizing, but refusing to apply the “apparent manufacturer” doctrine to hold Trans liable for a heater manufactured and sold by its subsidiary, Trans-Canada).

59. See, e.g., *Torres v. Goodyear Tire & Rubber Co.*, 901 F.2d 750 (9th Cir. 1990) (holding Goodyear liable for defective tire on an “enterprise theory” because it significantly participated in the overall process by which the tire reached its consumers and had the right to control the incidents of manufacture and distribution); see also Franklyn, supra note 17, at 20–30 (reviewing the “enterprise theory” cases).

60. See supra notes 17–18 and accompanying text.


62. See *Mobil Oil Corp. v. Bransford*, 648 So. 2d 119, 124 (Fla. 1995).
chooses to deal with, or use the products of, a seller of goods or services, the customer is deemed to have accepted the seller’s entity structure, modified only by the legal rules for entity-disregard. In the vast majority of cases, this deemed acceptance constitutes the baldest of legal fictions. The customers—whether they are consumers or businesses—will have made their decisions to deal without knowing even the names of the entities with whom they are deemed to have dealt, to say nothing of those entities’ levels of financial responsibility, available insurance coverages, or vulnerabilities to entity-disregard. Most customers believe that the trademark owner will be liable and do not anticipate the restriction of liability based on entity structure.

Even the most diligent customer could not independently gather the information necessary to evaluate the entity structure. For large, publicly held companies, the names of the dozens or hundreds of entities that compose the seller’s group are matters of public record. But those public records do not say what aspects of the business are conducted by what entities or indicate which of the group’s assets are owned by which members. Public companies disclose only consolidated financial information for the corporate group as a whole. They are not required to, and do not, disclose financial information for individual entities within the group—even though the individual entities’ financial conditions are determinative of customers’ abilities to recover. Nor are public companies required to disclose even the names of the entities, within or outside their corporate group, that do business under their trademarks.

63. These rules include piercing the corporate veil, substantive consolidation, and enterprise liability.
64. See Emerson, supra note 20, at 658–59. Emerson reports empirical findings that over 80% of both the student and [older group of respondents] believed that franchisors are legally obligated to guarantee the services and goods provided by their franchisees, and almost all of these respondents, plus over 80% of the public respondents, felt that even if franchisors are not so required, most franchisors do in fact give such guarantees. . . . [A]bout half of the students and [older group] respondents with an answer thought that franchisors could be forced to pay judgments entered against insolvent franchisees.
66. See id. 229.301–302 (permitting the filing of consolidated financial data). That the filing of financial data in consolidated form is the universal practice can be confirmed by examining the annual (Form 10-K) and quarterly (Form 10-Q) reports actually filed. These reports can be found on the EDGAR website, at http://www.sec.gov/edgar/searchedgar/webusers.htm (last visited Mar. 6, 2002).
67. That is, no law requires that a corporation—even a publicly traded one—disclose the names of its franchisees or trademark licensees, and corporations generally do not disclose them. See, e.g., JVC Adds Smaller D-ILA, Consumer Electronics, May 22, 2000, LEXIS, News Library, Allnews file (noting that JVC officials “declined to disclose the names of licensees” who would manufacture its new, lightweight projector).
Even if Regina Yoder had engaged a lawyer to assist her in her initial purchase of a "Honeywell" keyboard, she probably could not have discovered the keyboard manufacturer's name. Further, even if Yoder and her lawyer had somehow discovered the manufacturer's name, they still could not have discovered the manufacturer's financial condition—even though the manufacturer was wholly owned by a public company. The acting entities’ financial conditions determine the effectiveness of liability under current law, but under current law the financial conditions of those entities are not public information—even for "public" companies. Had the manufacturer of Yoder's keyboard been a private company, the only information available would have been that which the company had voluntarily chosen to release.

In the current system, customers can obtain information sufficient to value the liability for which they contract only by compelling their sellers to divulge it as a condition of dealing. That is in fact what the most sophisticated customers do in the largest deals. Those customers use the information to negotiate which entities will be liable, in what amounts, and how much insurance the seller will provide.

The calculation of liability value from an entity structure can be complex. That complexity sometimes confuses even the most sophisticated players. For example, after Pennzoil won its $10 billion judgment against Texaco, Inc., the parent company of the Texaco group, Texaco, Inc. transferred assets to other

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68. Bull HN Information Systems, Inc. is mentioned only a single time in Honeywell Inc.'s Form 10-K for the year in which the complaint was filed. The reference is to office space, not products manufactured. See HONEYWELL, INC., FORM 10-K FOR THE YEAR ENDING MARCH 31, 1993, at Item 2, available at http://www.sec.gov/edgar/searchedgar/webusers.htm. It appears that Regina Yoder and her lawyer were able to determine the manufacturer of the keyboard only through discovery. See Yoder v. Honeywell Inc., 104 F.3d 1215, 1219 (10th Cir. 1997):

On December 7, 1994, Honeywell and plaintiffs jointly inspected the keyboards used at the reservation center where Regina Yoder had worked. Honeywell then formally notified plaintiffs on February 2, 1995, that Honeywell Information Systems, Inc., a subsidiary of Honeywell now known as Bull HN Information Systems, Inc., manufactured the keyboards.

Id.

69. See, e.g., HONEYWELL, INC., supra note 68 (presenting financial information only for the group, not for entities within the group).

70. Both public and private firms often release information for credit purposes. Such releases are, however, voluntary. Most of the releases are through Dun & Bradstreet, Inc., which holds a 90 percent share of the market for business credit reporting. See Trief v. Dun & Bradstreet Corp., 840 F. Supp. 277, 279 (S.D.N.Y. 1993) ("D&B Credit Services controls approximately ninety percent of the market for corporate credit information."). Only subscribers who pay a monthly fee have access to Dun & Bradstreet information.

71. Although none of the opinions in the case expressly states that the judgment was solely against Texaco, Inc., it was the only party to any of the reported opinions. See, e.g., Texaco, Inc. v. Pennzoil Co., 626 F. Supp. 250, 250 (S.D.N.Y. 1986), modified, 784 F.2d 1133, 1133 (2d Cir. 1986); Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768, 768 (Tex. App. 1987), rev'd, 481 U.S. 1, 1 (1987).
corporations in the Texaco group to avoid the attachment of judgment liens. The incident prompted Pennzoil CEO Hugh Leidke to observe plaintively that “...thought that when we were suing Texaco, we were suing all of Texaco.”

If entity structures can surprise the parties to multibillion dollar litigation, they are certainly capable of surprising the buyers of industrial machines or Happy Meals. The vast majority of customers will have insufficient leverage to force disclosure of the financial information necessary to evaluate the financial responsibility of the persons with whom the customers deal. Among those who do have sufficient leverage, most will be engaged in transactions too small to warrant the expense of forcing and analyzing such a disclosure. The large majority of customers must contract solely on the basis of information readily accessible at the point of contracting. In most cases, that information will be the trademark and what the buyer already knows about the trademark from other sources.

Thus, most customers contract for liability on the basis of trademark, but receive liability (or fail to receive it) on the basis of entity structure. Because they cannot investigate the entity structure, they cannot evaluate the liability they are buying. The effect is to preclude meaningful competition on the basis of the financial responsibility of the seller. Sellers who choose to be financially responsible must compete in markets in which customers cannot distinguish them from sellers who choose to be financially irresponsible. The result is an unhealthy incentive for all sellers to externalize the costs of liability by adopting judgment-proof entity structures.

The solution to this problem is to impose liability on the entity that owns the trademark under which the goods or services are sold. This proposed rule—which I refer to as trademark owner liability—would not create any new

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72. See THOMAS PETZINGER, JR., OIL & HONOR 430 (1987). But see id. at 434 (“A Texaco executive later swore in an affidavit that the refinery switch was a long-planned move intended as part of a plan to consolidate the assets of Getty Oil.”).


74. Compare O’Banner v. McDonald’s Corp., 670 N.E.2d 632-35 (Ill. 1996) (holding that McDonald’s was not liable for a slip and fall at a franchisee’s restaurant), with Emerson, supra note 20, at 680 (finding that only 14 to 19 percent of interview respondents realized that McDonald’s restaurants were locally owned and operated).

75. See, e.g., Stephen L. Carter, The Trouble with Trademark, 99 YALE L.J. 759, 759 (1990) (“Successful marks are like packets of information. They lower consumer search costs, thus promoting the efficient functioning of the market.”).

76. The entity that owns the trademark may be only the trademark subsidiary of a corporate group. Some may prefer that liability be imposed on the entire group doing business under the trademark. But implementing that alternative using only bright-line rules would be difficult, if not impossible. In Part IV, infra, I demonstrate that the end result would not be materially different.
liability.\textsuperscript{77} What it would do is impose already-existing liability on an additional party—the trademark owner—thereby improving an injured party’s chances of recovery and, ultimately, the chances that appropriate levels of care would be taken. The proposed rule would accomplish that by making the trademark owner jointly and severally liable for various acts of authorized users of the trademark.

II. THE RATIONALE FOR TRADEMARK OWNER LIABILITY

A. Trademark Owners, Rather than Customers, Should Monitor Trademark Users

Businesses display trademarks in order to reassure their customers. Current law presumes that if a customer responds to a trademark by transacting with the business that displays it, the customer has contracted for the liability of whatever entity is doing business under the trademark. That is not the actual intention or expectation of most such customers.\textsuperscript{78} They expect the trademark owner to be responsible for business done under the mark. That alone should be reason for abandoning the presumption.

The proposal for trademark owner liability set forth in this Article does not, however, rest merely on the necessity to honor the intentions or expectations of customers. If it did, trademark owners might respond by making perfectly clear to customers that they do not stand behind the products sold or the businesses conducted under their trademarks. While that would make the system of contracting for liability transparent, it would not solve the problem of system and market failure that ultimately gives rise to the need for trademark owner liability.\textsuperscript{79} The problem is that customers lack the informa-

\textsuperscript{77} Hence, my proposal sidesteps the “enterprise liability” debate over the extent to which manufacturers should be liable for injuries resulting from use of their products. See, e.g., James A. Henderson, Jr. & Jeffrey J. Rachlinski, Product-Related Risk and Cognitive Biases: The Shortcomings of Enterprise Liability, 6 ROGER WILLIAMS U. L. REV. 213, 215 (2000) (“Numerous legal scholars have proposed alternatives to the traditional fault-based system for generic product hazards.”). Trademark owners should share whatever liability is appropriately placed on manufacturers of products sold under the mark.

\textsuperscript{78} See Emerson, supra note 20 (presenting surveys of college students’ and older groups’ understandings of the law).

\textsuperscript{79} A system failure occurs when the structure of the system is incapable of achieving the acknowledged goals of the system. See LoPucki, supra note 19, at 506 (discussing the search for inconsistency between system goals and system functions). A market failure occurs when a particular system—a market—is incapable of achieving the acknowledged goals of a market—the proper allocation of goods and services. See, e.g., William P. Albrecht, Regulation of Exchange-Traded and OTC Derivatives: The Need for a Comparative Institution Approach, 21 J. CORP. L. 111, 117 (1995) (defining market failure). Requiring customers to contract without adequate information causes both a system and a market failure.
Trademark-Based Liability System

...tion necessary to evaluate the financial responsibility of the entities whose liability is offered.

Trademark owner liability would address the problem by providing an alternative, mandatory content for the contract. When goods or services are sold under a mark, the trademark owner guarantees liability for defects in the product and the financial responsibility of the trademark owners’ licensees. The effect of the rule is to remove most of the risk of defective products and licensee insolvency from the customer and place it on the trademark owner, to the extent of the trademark owner's wealth.

The advantage to the liability system is that the trademark owner—unlike the customer—typically has both the opportunity and the bargaining leverage to investigate and control the risk of insolvency. Trademark owners license relatively few users of their marks. Typically, those licensees are other members of the corporate group, franchisees, or joint venturers. Trademark owners already have, under current law, the obligation to monitor the activities of those licensees and control the quality of the goods and services sold under the mark. Thus, this Article's proposal would merely impose liability for failure to fulfill an already-existing duty. In furtherance of their already-existing duty, the trademark owners typically obtain financial statements from licensees and require that licensees indemnify the owners against liability arising out of the licensee's business. Thus both the information system and the contracts necessary for the proposed system are already in place.

By contrast, the information system and contracts necessary for customers to monitor and respond to the activities of licensees do not exist and their

80. To illustrate, "at the height of the Cabbage Patch Kids' popularity, [the trademark owner] had approximately 127 licensees who marketed hundreds of different related products." Original Appalachian Artworks, Inc. v. S. Diamond Assocs., Inc., 44 F.3d 925, 926 n.2 (11th Cir. 1995). The products were undoubtedly sold through a much larger number of outlets. Typically, the trademark owner licenses dealers or franchisees but not mere resellers of its products.

81. See, e.g., 2 MCCARTHY, supra note 18, § 18:42 ("[N]ot only does the trademark owner have the right to control quality, when it licenses, it has the duty to control quality."). Professor David Franklyn points out that trademark law requires a lower level of control than that which would render the trademark owner liable under tort law. See Franklyn, supra note 17, at 45-46. He notes that "[a]lmost every court to address this issue has recognized that the Lanham Act quality control requirement exists mainly to protect the trademark licensor's ownership rights in its mark and is not the basis for a tort duty." Id. at 46. My point is in no way in conflict with his. My point is merely that current law has already put trademark owners in such a position that they need to inform themselves regarding the quality of their licensees' products and their licensees' financial responsibility.

82. See, e.g., 5 JEROME GILSON, TRADEMARK PROTECTION AND PRACTICE, at Form 28-3 § 9 (Michael R. Graham & Kevin J. McDevitt eds., 2001) (presenting a form licensing agreement providing indemnification "against ... suits ... arising out of Licensee's promotion, advertising, use or sale of goods and services under the Mark"); id. at Form 28-4 § 9(2) (presenting a form licensing agreement providing indemnification "against ... liabilities ... or costs ... arising from the business ... of Licensee").
creation is impractical. This advantage is magnified by the fact that the number of trademark owner-licensee relationships is much smaller than the number of licensee-customer relationships. The smaller number of relationships means that contracting costs will be lower in a system in which trademark owners rather than customers must monitor. As Professor Alan Sykes has noted, vicarious liability—such as the trademark owner liability advocated here—is more likely to be efficient when contracting costs are low. More monitoring and contracting would be necessary for customers, rather than trademark owners, to control licensees.

If the law is changed to make trademark owners jointly and severally liable with authorized users of their marks, customers will be able to rely on the liability of the trademark owner. The resulting market for liability will be improved because the information available to most customers—information relating to the trademark—will provide a better basis for estimating the financial responsibility of the seller and hence the value of the liability component of the sale.

The difference in utility of the information conveyed by a trademark and that conveyed by an entity structure results from the fact that a trademark, unlike an entity structure, is an effort to communicate. That is, the trademark is the owner's means of identifying itself in the marketplace. Most owners want their customers to recognize their trademarks and advertising and to identify them with the owners' goods or services. Unless customers can distinguish the owner's trademark from the trademarks of others, the owner's trademark will not have the desired effect of inducing those customers to deal. Hence, reputable businesses seek trademarks that are distinctive, and often use several trademarks together to make them easier for customers to recognize. For example, the Mobil Mini Mart that Bransford patronized did not rely solely on the Mobil name, but also "prominently displayed [Mobil's] logo [a winged red horse], insignia, and color scheme in order to induce customers to patronize the station.... Employees were required to wear Mobil uniforms." This redundancy undoubtedly contributes to the effectiveness of the communica-

83. See Alan O. Sykes, The Economics of Vicarious Liability, 93 YALE L.J. 1231, 1232 (1984) ("[T]he efficiency of vicarious liability depends in large measure on the magnitude of certain transaction costs in the negotiation and enforcement of a customized allocation of risk in agency contracts.").

84. See generally Ian Ayres & Paul M. Goldbart, Optimal Delegation and Decoupling in the Design of Liability Rules 1 (2001) (unpublished manuscript, on file with author) (arguing in the context of nuisance law that "allocative concerns can be decoupled from distributive concerns").

85. See Lemley, supra note 2, at 1688 ("Trademarks are a compact and efficient means of communicating information to consumers."); id. at 1690 ("[Economists] have emphasized the efficiency by which trademarks and advertising communicate useful information to consumers, and thereby reduce consumer search costs.").

86. Mobil Oil Corp. v. Bransford, 648 So. 2d 119, 122 (Fla. 1995).
 Trademark-Based Liability System

...tion. Competitors of the trademark owner can neither register nor use a trademark that is likely to cause confusion. The power—and hence the value—of a trademark depends on the size of the market, the degree of recognition that mark has in it, and the perceived reputation of the trademark owner. Because this kind of information is inherently public, customers are in a relatively good position to estimate the value of a trademark, at least in rough terms.

Businesses do not use their entity names to communicate with customers. Perhaps for that reason, entity names are often confusingly similar. Few customers would know the difference between Mobil Corporation, Mobil Oil Corporation, Mobil Oil Company Limited, and Mobil International Petroleum Corporation, and even fewer would have any idea which was capable of providing financial assurance. For readers of this Article, it is probably only the presence of the trademark “Mobil” in these names that suggests that any of these corporations are capable of providing any financial assurance at all.

The trademark owner liability proposed here will not likely come to rest with the trademark owner. Many trademark licensors already require financial responsibility and indemnification from their licensees. Under the proposed regime of trademark owner liability, trademark owners’ incentives to impose such requirements will be greater. The change will be an improvement because it will compel trademark owners and their licensees to internalize liability that they can externalize under current law. The prospect of internalization will provide trademark owners and their licensees with incentives to employ cost-effective measures to reduce injuries.

Forcing trademark owners and their licensees to internalize liability increases their costs. They may pass some of those cost increases on to

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88. See id. § 1114(1) (1994).
89. That is, they would know that the liability of Microsoft or McDonald’s was valuable and that the liability of Jake’s Used Cars or Joe’s Restaurant might not be.
90. For example, Federated Department Stores is the parent corporation of a group that owns several high-visibility department store chains, including Bloomingdale’s, Macy’s, Burdines, Bon Marché, and Lazarus. See http://www.federated-fds.com/home.asp (last visited Mar. 6, 2002). Very few people think of these venerable names as “Federated Department Stores.”
91. See 5 GILSON, supra note 82, at Form 28-3, § 9.
92. Only the assets of licensees are at risk in the current system, but the assets of both trademark owners and licensees would be at risk in the new system. Because more sources of recovery would be available to them in the new system, plaintiffs would tend to collect larger portions of the same liability. The statement in the text assumes that trademark owners will be able to shift at least some of the additionally collected liability to licensees by contract.
93. See, e.g., Robert K. Rasmussen, An Essay on Optimal Bankruptcy Rules and Social Justice, 1994 U. ILL. L. REV. 1, 32 (“To the extent that a firm knows that it will not have to fully compensate its future tort victims, it has too little incentive to take care to prevent accidents in the first instance.”); Alan O. Sykes, The Boundaries of Vicarious Liability: An Economic Analysis of the Scope of Employment Rule and Related Legal Doctrines, 101 HARV. L. REV. 563, 569 (1988) (“Vicarious liability reduces or eliminates some of the inefficiencies that can arise under personal liability.”).
customers in the form of higher prices. Some of those customers will be people of modest means. That is not, however, reason to reject the proposal. First, some of the liability will be eliminated rather than passed along. That is, the higher costs will compel some trademark owners and their licensees to adopt cost-effective measures to reduce the injuries they inflict on customers. That reduction will be a net social gain. Second, when viewed properly, the “higher” prices in a trademark owner liability regime are not in fact higher. The higher nominal price under a liability-internalizing regime is more than offset by a hidden cost—the uncompensated injuries that customers suffer under a liability-externalizing regime.

Professor John Hanks has proposed that franchisors be liable for the torts of their franchisees as guarantors,94 rather than jointly and severally with the franchisees, as I propose here. The crux of Professor Hanks’s argument is that most franchisees are financially responsible with respect to most claims:

[I]t is both inefficient and unfair to require franchisors to regularly defend themselves at substantial costs and great distances from their central offices against claims of vicarious liability when plaintiffs have adequate remedies against local franchisees who are, after all, the parties responsible for the plaintiffs’ injuries and other losses. Much of those costs can be avoided by substituting guarantor liability for the current vicarious liability of franchisors since plaintiffs would not have a cause of action against a franchisor (assuming the franchisor has not itself been negligent) unless the franchisee was unavailable to be sued or unable to pay a judgment.95

Hanks’s proposal has two weaknesses. First, his factual assumption that franchisors are compelled by current law to “defend themselves at substantial costs and great distances from their central offices” may be incorrect. If the franchisees carry liability insurance, the insurance company is likely providing the defense by retaining local counsel.96 The franchisor would have a financial stake only in the cases in which liability might exceed the insurance and other resources of the franchisee. That places opponents of trademark owner liability on the horns of a dilemma. Both the current system and the system Hanks proposes place some of the risk that liability might exceed the insurance and other

94. See Hanks, supra note 18, at 8 (“In place of the current vicarious liability imposed on the franchisor, this Article proposes imposing liability on franchisors as guarantors.”).
95. Id. at 9.
96. See, e.g., Charles Silver & Kent Syverud, The Professional Responsibilities of Insurance Defense Lawyers, 45 DUKEL.J. 255, 265 (1995) (“For the last century, these common insurance arrangements have permitted the [insurance] company to select counsel to defend an action, to supervise counsel’s litigation and settlement strategy, and to settle claims within policy limits at the company’s discretion.”).
resources of the franchisee on the innocent plaintiff. If the risk is minimal, there is little reason not to adopt trademark owner liability. If the risk is substantial, it means that trademark owners are externalizing substantial liability and many injured plaintiffs will go uncompensated. Moreover, imposing trademark owner liability would reduce the potential for conflict between trademark owners and their licensees—both would bear the same liability in the initial action. That would make it easier for insurers to write one policy and provide one defense for the owners and their licensees.

Second, Hanks fails to say whether he would permit the plaintiff to sue on the guarantee in the initial lawsuit. If he would, the franchisor would be put to a defense in every case. If he would not, a second lawsuit would be necessary whenever the franchisee did not pay the judgment rendered in the first. That second lawsuit would happen long after the litigated events, the franchisor would be entitled to retry exactly the issues resolved in the first lawsuit—including the amount of the plaintiff’s damages—and one side or the other would be compelled to sue or defend “at substantial costs and great distances” from their homes. To the extent such a splitting of the litigation were desirable, the courts could do it in a trademark owner liability regime. Current law already gives discretion to sever and stay particular causes of action in the interests of efficiency. That discretion should continue, making the kind of protection Hanks proposes redundant.

B. Trademark Owner Liability Should Be Non-Disclaimerable

Disclaimer of trademark owner liability should not be permitted. If it were, trademark owners would almost certainly seek to maintain the status quo through the change in regimes by requiring their customers to accept their disclaimers of liability. Mobil, for example, might continue to franchise the same chain of minimarts under the same family of trademarks, but prominently display a statement that “This business is operated by Bud and Judy’s Mini Mart. Mobil assumes no liability.” Three problems make it inadvisable to give effect to such disclaimers.

97. John Hanks’s system does it in a subtler fashion, merely delaying the lawsuit against the trademark owner rather than barring it. In some cases, the trademark owners will become insolvent, lose their insurance, or judgment proof themselves in the interim.

98. See Applewhite v. Reichhold Chems. Inc., 67 F.3d 571, 574 (5th Cir. 1995). As stated by the Applewhite court:

Under Rules 20 and 21, the district court has the discretion to sever an action if it is misjoined or might otherwise cause delay or prejudice. Further, the district court also has discretion to sever claims under Federal Rule of Civil Procedure 42(b), in furtherance of convenience or economy, or to prevent prejudice.

Id. (citation omitted).
First, and most importantly, the customer does not know who Bud and Judy's Mini Mart is and has no means for determining its level of financial responsibility. Bud and Judy's Mini Mart may or may not own the premises. It may or may not carry substantial amounts of liability insurance. Even if customers confronted with such disclaimers understood that they could not rely on the liability of the trademark owner and knew the name of the entity on whose liability they could rely, they would neither know nor be able to discover the value of that liability.

Customers would be forced to choose among offers of liability without sufficient facts, which would continue the system and market failures that currently exist.

Second, traditional forms of disclaimers would be unlikely to make customers actually aware they were not dealing with the trademark owner. Traditional disclaimers would be less prominent than the trademarks, they would be inherently ambiguous because they would conflict with the assuring message of the trademarks, they would lack the redundancy in use that is typical of trademarks, and they would lack the associationally generated emotional impact of trademarks. The little empirical evidence available suggests that such disclaimers would not communicate effectively.

99. To assess the financial responsibility of an otherwise unknown licensee, the customer would need to know what insurance the licensee carried, the entity structure of the licensee, and the financial condition of the licensee. Even if this information were supplied, most customers would not be able to evaluate it. The transaction costs would be enormous.

100. See Franklyn, supra note 12, at 722 (proposing, with respect to an automobile, “a large sticker,” presumably on the window).

101. See id. at 722-27 (discussing the mixed message sent by such a disclaimer used in conjunction with the trademark), Michael M. Greenfield & Joshion M. Schindler, Liability of a Franchisor to a Franchisee 34-35 (1988) (unpublished manuscript, on file with author) (“Whether or not a sign over the door proclaims the independence of the franchisee, it remains true that the consumer actually relies on the franchisor, not the franchisee, and that the franchisor intends and encourages this reliance.”).

102. See supra note 86 and accompanying text.

103. That is, a principal purpose of advertising is to create positive, comforting associations with the trademark. For disclaimers to have the same emotional impact would require advertising that associated the trademark with the dangers created by the disclaimers. One can imagine, for example, mandatory trademark owner advertising featuring heartbreaking vignettes of lives destroyed by acquiescing in ill-advised disclaimers. Except in extraordinary circumstances—such as cigarette smoking—such advertising is not a practical possibility.

104. See Emerson, supra note 20, at 656 (finding that only about a third of the public and franchise customer respondents in Gainesville, Florida knew that the local Coldwell Banker Realtors were locally owned and operated even though the franchise “states in all advertisements that it is independently owned and operated” and includes in such advertisements the name of the local owner).

Invalidating ineffective disclaimers in litigation is not an appealing solution to this problem for several reasons. First, the issue would arise frequently, necessitating many lawsuits. Second, the validity of the disclaimers would depend on a factual inquiry and hence be costly to litigate. Third, many injured parties would be unaware of their rights to invalidate ineffective disclaimers and so would not exercise, or be protected by, them.
Third, the legitimate purposes for which disclaimers of vicarious trademark owner liability might be used could be accomplished more transparently by disclaimers of the underlying direct liability. Even under a trademark owner liability regime, manufacturers, sellers, and franchisees would continue to have the right to disclaim direct liability under the Uniform Commercial Code and other substantive law directed specifically at the disclaimer issue,\textsuperscript{105} subject to already existing procedural and substantive limitations.\textsuperscript{106} If, under the proposed regime, manufacturers, sellers, and franchisees disclaim in accord with the substantive law of disclaimer, no liability will exist to be transmitted vicariously to the trademark owner.

Trademark owners would need the additional right to disclaim trademark owner liability in only two circumstances. The first is when the trademark owner wanted to disclaim liability of a nature its licensees could not. Such disclaimers should be barred to licensors for the same reasons they are barred to licensees. The second circumstance is when the parties would disclaim for the purpose of limiting liability to the extent of the licensee's financial resources. That purpose could be achieved without disclaimer of trademark owner liability, simply by specifying the extent of the licensee's resources and limiting the licensee's liability to that amount. Customers are more likely to understand such an express limit on liability than a limit that flows by operation of law from the customer's "acceptance" of a particular entity structure.

III. THE CONDITIONS OF TRADEMARK OWNER LIABILITY

The appeal of trademark owner liability will be greater if it can be implemented through rules that are both principled and specific. This part begins an exploration of what those rules might be.

A. To Whom Should Trademark Owner Liability Run?

The rationale for trademark owner liability—that trademark owners are better able to evaluate the entity structures of their trademark users than are customers—suggests that trademark owner liability should be limited to customers and similarly situated persons. For this purpose, a customer is a person who buys goods or services in the ordinary course of the seller's business.

\textsuperscript{105} See, e.g., U.C.C. § 2-316 (2001) (regulating the disclaimer of warranties in sale-of-goods transactions).

\textsuperscript{106} See, e.g., V.S.H. Realty, Inc. v. Texaco, Inc., 757 F.2d 411, 418 (1st Cir. 1985) (discussing whether a particular disclaimer was invalid as an attempt to contract out of liability for fraud); Kaiser Aluminum & Chem. Corp. v. Ingersoll-Rand Co., 519 F. Supp. 60, 71 (S.D. Ga. 1981) ("In order to contract out of liability for negligence, the contract must specifically disclaim liability for negligence.")
Customers would include both consumers who buy from businesses and businesses that buy from other businesses. In most instances, business-customers are no better situated than consumer-customers to evaluate the entity structures of their sellers. Some customers may lack the necessary sophistication and skills, but for most the problem will be that the amounts in issue are too small to justify the expense of investigation and analysis. The rationale for trademark owner liability extends as much to Price Waterhouse's purchase of 100 Honeywell keyboards as to Regina Yoder's purchase of one. Neither customer can cost-effectively figure out who is behind the Honeywell trademark.

United Airlines' purchase of a dozen jumbo jets from Boeing is a different case. Given the amount of money at stake, United Airlines can, and probably will, investigate and analyze Boeing's entity structure. With respect to this transaction, United Airlines is not in need of trademark owner liability. Providing that liability, however, is unlikely to do any harm because even in a regime that did not permit disclaimer of trademark owner liability, sophisticated customers would as a practical matter still have the ability to contract around trademark owner liability. As noted previously, the parties retain the right to disclaim all or any part of the underlying liability as permitted by other law, and when the parties do that, the result is to disclaim the trademark owner liability as well.

If the parties to this transaction wanted to limit Boeing's liability to an amount equal to the assets owned by a particular Boeing entity, they could so provide in their agreement. To prevent trademark owners from using this technique in small transactions the courts should give effect to such disclaimers only if the trademark owner discloses to the customer both the owner's entity structure and the information necessary to evaluate it.

The rationale for trademark owner liability recommends that the liability operate not just in favor of customers, but also in favor of third parties injured by the products or services sold under the trademark. Those third parties would include, for example, a person injured by reliance on a negligently prepared audit report and a passenger injured in the crash of a defective airliner. Such persons are no better situated than customers to evaluate the entity structures of the sellers, but they are often responsive to the trademarks displayed.


108. See supra Part II.B.

109. An alternative means of dealing with the problem would be to permit disclaimers of trademark owner liability by some kinds of parties in some kinds of cases. See Woodward, supra note 107, at 275-82 (discussing the line-drawing techniques used in various legislation).

110. Such a prohibition would be needed to prevent trademark owners from using boilerplate versions of substantive-liability disclaimers as the equivalent of trademark owner liability disclaimers.
Some aspects of third-party liability are controversial, but this Article does not intend to engage that controversy. Legislators should eliminate inappropriate third-party liability. But to the extent that third parties remain entitled to sue those doing business under a trademark, they should be entitled to sue the trademark owner. To put the argument another way, lawmakers should fix the scope of third-party liability with the public interest in mind; trademark owners should not be able to override lawmakers' decisions by deploying entity structures. References to customers throughout this Article should be understood to include such third parties to the extent of their rights under substantive law.

The principal groups omitted from protection by the “customer” test would be lenders and other suppliers to the trademark owner’s business, employees, and tax and regulatory authorities. Most lenders investigate the entity structures and financial responsibility of their borrowers as part of the credit-checking process, so few lenders are in need of trademark owner liability. Lenders and their borrowers often use the borrowers’ entity structures to allocate risks between them. For example, banks often require, as a condition of the making of a real estate loan, that the borrower set up a new entity to hold title to the property. Imposing trademark owner liability would disrupt these relatively benign established practices.

Probably few tax and regulatory authorities are in need of trademark owner liability. Tax and regulatory authorities are repeat players with the power to control the entity structures of their debtors or to impose liability

111. See, e.g., Ernst & Young L.L.P. v. Pac. Mut. Life Ins. Co., 51 S.W.3d 573, 577 (Tex. 2001) (stating that an accounting firm may be held liable to a third party for fraudulent misrepresentations in an audit report if the third party can show that the firm had a “reason to expect” that the third party would rely on the misrepresentations); Richard I. Miller & Michael R. Young, Financial Reporting and Risk Management in the 21st Century, 65 FORDHAM L. REV. 1987, 2013 (1997) (“The issue of those who may sue an accountant has plagued the profession for more than a half-century.” (footnote omitted)).

112. See, e.g., In re Kingston Square Assocs., 214 B.R. 713 (Bankr. S.D.N.Y. 1997) (involving real estate collateral separated among numerous corporations, with control over bankruptcy filing residing with a director selected and paid by the bank lender). The purpose of the condition is to avoid entanglements between the bank’s loan and other extensions of credit to the debtor. If, for example, the borrowing entity files bankruptcy, the case will be a “single-asset” bankruptcy and the bank will be the only substantial creditor.

113. That is, governments can, and often do, determine by regulation the entity structures of the businesses with whom they deal. See, e.g., Paul J. Folkling & Scott A. Cammarn, Overview of the Gramm-Leach-Bliley Act, 4 N.C. BANKING INST. 1 (2000) (describing federal limitations on the entity structures of banks). State and federal regulatory laws often impose financial responsibility requirements on regulated firms. See, e.g., N.C. GEN. STAT. § 53-2 (2001) (requiring minimum capital of $2 million to charter a bank in North Carolina). Regulations often reach the entire corporate group—defined in terms of control—not just the particular entity that engages in the regulated activity. See Blumberg, supra note 25, at 307–11.
on their debtors without respect to their entity structures. Their systems and techniques have evolved over time to afford them the level of protection for which there is political support.

Suppliers—particularly smaller suppliers—and employees constitute intermediate groups for whom trademark owner liability will sometimes be appropriate. Their cases are less compelling than those of customers.

A supplier is the business on the other end of the transaction from a customer. That is, if Micron is Itel’s customer, then Itel is Micron’s supplier. One might assume that if Itel should have trademark owner liability to Micron, Micron should also have trademark owner liability to Itel. The supplier-customer relationship, however, differs from the customer-supplier relationship in one crucial respect. Suppliers extend substantial amounts of credit to customers, but customers extend only small amounts of credit to suppliers. As a result, suppliers are more concerned with liability and more likely to investigate the entity structures and creditworthiness of their customers. Many, if not most, suppliers have access to the business credit reporting system and use it in their capacity as suppliers. Relatively few customers have such access, and even those who do are unlikely to use it in their capacity as customers. Thus, generally speaking, suppliers are better situated than customers to evaluate the entity structures of those with whom they deal, and consequently less dependent on trademarks.

Employees are also better positioned than customers to understand a business’s entity structure. Employees extend credit to their employers in that they do the work before they are paid and they accrue entitlements to benefits such as vacations, sick leave, and pensions. Because employment is usually a major transaction for the employee, employees often have sufficient incentives to investigate the entity structures and creditworthiness of their employers. Because they are inside their employers’ businesses, employees are generally better situated than customers to obtain information. On the other hand, many employees lack the sophistication necessary to understand the precariousness of their positions as creditors and the significance of the facts

114. See, e.g., United Dominion Indus. Inc. v. United States, 532 U.S. 822 (2001) (holding that product liability losses are tax characteristics attributable to corporate groups, not to entities within the groups).

115. Dun & Bradstreet is the principal business credit reporting agency in the United States. That firm offers a trademarked D-U-N-S Numbering System to identify companies and company affiliations for its subscribers. The purpose is to assist subscribers in understanding their prospective debtors’ entity structures. See DUN & BRADSTREET CORP., FORM 10-K FOR THE YEAR ENDING DECEMBER 31, 1998, at Item 1 (mentioning the D-U-N-S system).
Trademark-Based Liability System

they discover.\textsuperscript{116} Trademark owner liability is thus probably appropriate for some employment relationships and not for others.

B. In What Circumstances Should Trademark Owner Liability Accrue?

The rationale for trademark owner liability—that trademark owners are better able to evaluate the entity structures of their licensees than are customers—does not warrant imputing the liability of everyone who deals in a trademarked product to the trademark owner. Some who deal in trademarked products are not even licensees. As Thomas McCarthy explains:

[T]he general rule is that a merchant or dealer who merely resells the branded goods without change is not infringing and needs no license. For example, a used car dealer has the right to sell a used FORD or CHEVROLET auto, clearly labeled as “used,” by describing it for what it is: a used car of that particular source. However, a license would be needed when the manufacturer of branded goods permits a dealer to hold itself out as an “authorized” dealer, repair outlet, and the like.\textsuperscript{117}

As a result, customers often rely on trademarks in transactions to which neither the trademark owner nor a licensee is a party.

Trademark owners are likely to know the entity structures of their licensees. But they are less likely to know the entity structures of the perhaps thousands of nonlicensees that merely buy and resell their products or supply components for inclusion in the products.\textsuperscript{118} As a result, liability should less often be imputed when the wrongdoer is not a licensee.

1. Nonlicensees

Only the defective-product liability of nonlicensee resellers and component manufacturers should be imputed to the owners of the trademarks under which the goods are sold. The imputation of defective-product liability is consistent with the function of trademarks. “A trademark carries with it a message that the trademark owner is controlling the nature and quality of the

\textsuperscript{116} For example, the highest priority available for the pre-petition claims of employees for wages and benefits under U.S. bankruptcy law ranks them behind the claims of secured creditors and expenses of administration. See Lynn M. LoPucki, Cooperation in International Bankruptcy: A Post-Universalist Approach, 84 CORNELL L. REV. 696, 710-11 (1999) (describing the priority of employment claims under U.S. bankruptcy law). That priority is available for only modest amounts. See 11 U.S.C. § 507(a)(2), (3) (Supp. V 1999) (limiting the combination of wages and benefits to $4300).

\textsuperscript{117} 2 MCCARTHY, supra note 18, § 18:41 (citations omitted).

\textsuperscript{118} To illustrate the latter circumstance, an automobile manufacturer may purchase a component—such as an engine—from another manufacturer without licensing that manufacturer to use the trademark under which the automobiles are sold.
goods or services sold under the mark." More importantly, the trademark provides the basis for informed decisionmaking by customers. As Honeywell v. Yoder illustrates, the buyers and users of trademarked goods have no practical means other than the trademark for knowing who manufactured or sold the goods. Buyers and users of goods must rely on the trademark owners to control all latent aspects of quality. Under current law, trademark owners already have the right, the ability, and a reputational incentive to control quality. Trademark owner liability would add a liability incentive to control quality.

On the other hand, trademark owners do not have the practical ability to monitor or control aspects of nonlicensees' businesses other than the quality of the trademarked products. The trademark owner may not know the ultimate source of some components of the trademarked product or the identities of the retail outlets that sell the trademarked product. In the nonlicensee context, therefore, trademark owner liability should be limited to defects in the product itself. It should not extend to other torts committed by nonlicensor component manufacturers or product resellers.

Separately owned, multiple trademarks are sometimes used to identify the same product. For example, a football helmet may bear both the trademark of the National Football League and that of the particular team. Children's pajamas may bear both the trademark of the pajama manufacturer and the trademarked image of a comforting cartoon character. In both circumstances, both trademark owners should be liable. In most such cases, both trademarks are intended to, and do, play material roles in inducing customers to purchase, and both trademark owners undertake the trademark owner's duty to control product quality. More importantly, the recognizable cartoon character on the pajamas are for some customers their only means for identifying the person

119. 2 MCCRATH, supra note 18, at § 18.42. But see Kevin Parks, "Naked" Is Not a Four-Letter Word: Debunking the Myth of the "Quality Control Requirement" in Trademark Licensing, 82 TRADEMARK REP. 531, 557–61 (1992) (arguing that trademark owners should not have an obligation to control the quality of the products sold under their marks).

120. Nevertheless, the drafters of the Restatement recently rejected trademark owner liability:

   The rule stated in this section does not, by its terms, apply to the owner of a trademark who licenses a manufacturer to place the licensor's trademark or logo on the manufacturer's product and distribute it as though manufactured by the licensor. In such a case, even if purchasers of the product might assume that the trademark owner was the manufacturer, the licensor does not "sell or distribute as its own a product manufactured by another." Thus . . . the licensor . . . is not liable under this Section of this Restatement.

RESTATEMENT (THIRD) OF Torts: PRODUCTS LIABILITY § 14 cmt. d (1998); see also supra note 18.

121. Professor Franklyn acknowledges that "[i]ndeed, it seems odd to say that licensors have a legal duty to police their licensees for quality, but then to presume that licensors are basically passive investors and thus entitled to a presumption of nonliability." Franklyn, supra note 17, at 45. Franklyn also notes that "virtually every trademark license contains boilerplate language giving the licensor the 'right to control the quality' of the licensed goods." Id. at 34.
with whom they deal. The liability should be joint and several, with the parties free to allocate the liability between them by contract.

To escape the rationale and result I propose in the preceding paragraph, Professor David Franklyn distinguishes two "non-classical" types of trademark licensing. In "collateral licensing" the owner uses the trademark on a different type of goods from those on which demand for the mark was first created. Franklyn uses General Motors refrigerators as an example. In "promotional trademark licensing," the owner uses the trademark to engender consumer identification with the mark. Franklyn uses Coke pants as an example, but he might well have used a cartoon character on pajamas. He then argues that the licensors in these kinds of arrangements do not have the ability to monitor the quality of the goods, and from that premise concludes that the licensors should be absolved of legal responsibility for the goods. His argument is flawed in two respects. First, it recognizes a violation of law—failure to control quality—as a reason for ignoring that law. By requiring licensors to control quality, the Lanham Act established the meaning of the trademark's appearance on goods. To the extent that trademark owners are unable to control quality in collateral and promotional licensing, those types of licensing are not entitled to an exemption from law. They are simply illegal. Second, acceptance of Franklyn's argument leads to the conclusion that the burden of judging the quality of goods should be on the customer. Whatever the difficulties for Coca-Cola in judging the quality of pants sold under its trademark, the difficulties for consumers are clearly much greater. Collateral and promotional licensors should have trademark owner liability for the same reasons as other licensors.

122. See id. at 12-14.
123. Id.
124. See id. at 12-13.
125. See id. at 46. Franklyn argues:
One cannot reasonably expect a collateral or promotional licensor to police its licensees' goods to determine whether they are of the same quality as other goods bearing the same mark, because the licensor has never manufactured other similar goods under that mark. Thus, the licensor could not possibly develop meaningful standards to ensure uniform quality.
Id. Kevin Parks makes a similar argument. See Parks, supra note 119, at 561-64.
127. Notice that Franklyn has hypothesized that Coca-Cola is unable to meet the trademark standard of insuring uniform quality. See Franklyn, supra note 17, at 16. Such a failure is grounds for cancellation of the mark. See supra notes 81, 119 and accompanying text. Franklyn should have argued that Coca-Cola was capable of controlling quality to meet the trademark standard, but not to meet the tort standard. But the disingenuous nature of that argument becomes apparent when one tries to use it to justify an entire class of licensing. That a huge class of trademark owners are capable of exercising enough control to meet one vague, abstract standard but not another is not merely unproven but implausible.
The rule of trademark owner liability I propose would distinguish the situation in which one of the trademarks was used in a manner that indicated it identified only a single component of the product. An example would be the Firestone trademark on the tires of a Ford SUV. Because customers would understand the Firestone trademark to relate only to the tires, Firestone should not be liable for defects in other parts of the SUV. Ford, however, should be liable for defects in any part of the SUV, including the tires, because it authorized use of its trademark in a manner that conveyed to customers that Ford stands behind the entire SUV, including parts not manufactured by Ford.

Under the U.S. Court of Appeals for the Ninth Circuit's view, it is possible for an owner's trademark to appear lawfully on goods without the trademark owner's permission. This exception appears to be quite narrow, however, applying only in circumstances in which customers do not infer "a connection between the [seller's] product and the trademark owner." When the exception does apply, the trademark owner should not be liable. In keeping with the rationale, trademark owner liability should accrue only upon authorized use of the trademark.

2. Trademark Licensees

Generally, trademark owners should be liable for wrongful acts committed by their licensees against customers. However, not all trademark license relationships are sufficiently close to warrant that extension of liability. For example, a store that sells sound systems at retail may be an "authorized dealer" or "franchisee" for dozens of manufacturers. None of those relationships may be much more than buyer-seller. A manufacturer may have thousands of such dealers or franchisees, little knowledge of their entity structures or financial responsibility, and little practical ability to obtain such knowledge. When such multiple dealer or franchisee relationships are visible to customers, they are unlikely to mislead. Customers who know that a business sells competing

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128. The trademark liability rule would thus be consistent with the underlying product liability rule. See RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 5 (1998) (making sellers and distributors of components liable only for defects in the components).

129. See Int'l Order of Job's Daughters v. Lindeburg & Co., 633 F.2d 912, 920 (9th Cir. 1980) (holding that jeweler's sale of rings bearing trademarked insignia of the Job's Daughters organization did not infringe the trademark because the insignia was a "functional component" of the ring). But see Boston Prof'l Hockey Ass'n v. Dallas Cap & Emblem Mfg., Inc., 510 F.2d 1004 (5th Cir. 1975).

130. Int'l Order of Job's Daughters, 633 F.2d at 919. Professor Mark Lemley argues persuasively that the exception should be broadened. See Lemley, supra note 2, at 1706–09; see also Alex Kozinski, Trademarks Unplugged, 68 N.Y.U. L. REV. 960 (1993).
products under competing trademarks should not suppose that any one of the trademark owners operates that business.\textsuperscript{131}

The same is not true when the dealer or franchisee represents only a single trademark owner. Exclusive representation of a single producer of trademarked goods or services implies that the trademark owner is, or takes responsibility for, the dealer or franchisee.\textsuperscript{132} In an exclusive representation arrangement, the trademark usually identifies the dealer or franchisee's business to customers. That is, they think of the business as a McDonald's restaurant or a Chevron gas station. Accordingly, I propose that the broad form of trademark owner liability—that which imputes liability for all wrongful acts of the licensee committed under the trademark—should apply only against those trademark owners who authorize their licensees to use the trademark, alone or in conjunction with another name, to identify the business.

Some trademark uses neither identify the trademark owner as the source of quality control for the product nor identify the business. They include all uses of certification or collective marks,\textsuperscript{133} the use of the Visa or Mastercard trademarks to indicate that the business accepts payment by a particular method,\textsuperscript{134} co-branding arrangements such as the placement of a Taco Bell

\textsuperscript{131} This situation does appear to satisfy the rationale for imposing trademark owner liability—failure to do so leaves the customer with no means for assessing the financial responsibility of the licensee with whom the customer is forced to deal. This situation is, however, distinguishable from the routine-disclaimer situation. Here the trademark owner is not capturing the economic benefit of appearing to take responsibility (though not liability) for acts of the licensee.

\textsuperscript{132} That implication would continue even if the trademark owner clearly disclaims liability for acts of the licensee. See, e.g., Parks, supra note 119, at 559 ("All trademarks indicate source, enabling the public to make purchasing decisions based on the reliability of that source. . . . There is no reason to alter the free market equation by imposing an artificial quality requirement with respect to products produced pursuant to a trademark license."). In essence, Parks is saying that even in the absence of liability, customers expect the market to force trademark owners to take responsibility for products sold under their marks.

\textsuperscript{133} A "certification mark" is a mark used by a person other than the owner of the mark "to certify regional or other origin, material, mode of manufacture, quality, accuracy, or other characteristics of such person's goods or services." 15 U.S.C. § 1127 (1994) (including definition of "certification mark"). An example would be the trademark of Underwriter's Laboratory on various consumer appliances to indicate compliance with particular performance standards.

A "collective mark" is a mark used by the members of a group or organization. See id. An example would be the use of a geographical designation to indicate the region where a particular wine was produced.

\textsuperscript{134} Visa and Mastercard license their trademarks for use by businesses that are authorized to accept their cards as payment for goods or services. Because Visa and Mastercard attempt to license only reputable businesses and in some circumstances reverse payments made by customers who later indicate dissatisfaction with purchases, display of the Visa or Mastercard trademark is widely understood as a guarantee of quality. Because Visa and Mastercard do investigate their licensees, they are probably better able to evaluate the licensees' entity structures and financial responsibility than are the licensees' customers. A case might be made for the imposition of trademark owner liability on Visa and Mastercard, but making it is beyond the scope of this Article.
restaurant inside Exxon stations,¹³⁵ and the display of the FedEx or UPS logos to indicate shipping options.¹³⁶ The identification-of-the-business test advocated here would not impose liability on them. It would, however, impose liability on any trademark owner that authorized the use of its mark in the name by which a business or business location was known. For example, Mobil Oil Corporation would be liable for torts committed in the operation of the Mobil Mini Mart, even if the name were changed to “Bud and Judy's Mobil Mini Mart.” Nor should the result change if the name on the business were “Bud and Judy's Mini Mart,” but the premises otherwise retained the same appearance, with Mobil logos, insignia, and color scheme. The authorized use of Mobil trademarks in a manner that customers understood to identify the business—not just the products sold by the business—as “Mobil” would be sufficient to impose trademark owner liability on the owner of the Mobil trademark. Use in a manner that communicated only that the business sold Mobil products would not be sufficient to impose trademark owner liability.¹³⁷

3. Trademark Sharing

Although controversial, the currently prevailing view regards a trademark as the “property” of the registrant.¹³⁸ Consistent with that view, a registrant has the right to enjoin another’s use of the mark if that use is “likely to cause confusion.”¹³⁹ Such an injunction may protect customers from confusing uses, and such protection is often cited in support of trademark as an institution.¹⁴⁰

¹³⁵. The example is Mark Lemley’s. Probably few customers would be confused regarding the identity of the party with whom they dealt in purchasing a burrito in such a station. Exxon and Taco Bell are endorsing each other by entering into such an arrangement, providing the basis for an argument that they should be liable for one another’s tort, but that is not an argument I choose to make here.

¹³⁶. Federal Express, United Parcel Service, and other common carriers license their trademarks for use by businesses that offer to ship customers’ purchases by the particular carrier. Because the carriers do only the most cursory evaluation of the entity structure and financial responsibility of their licensees, the rationale for trademark owner liability probably does not apply to them.

¹³⁷. If substantially all of the products sold by a business were the products of a particular trademark owner, the products themselves might convey to customers an affiliation between the business and the trademark owners. In that event, nondisclaimable trademark owner liability should accrue. The business could escape liability by also prominently selling the products of the trademark owner’s competitors.

¹³⁸. See, e.g., Lemley, supra note 2, at 1705 (“[C]ourts are increasingly treating trademarks as if they were property in their own right.”).


¹⁴⁰. See, e.g., Lemley, supra note 2, at 1695 (“We give protection to trademarks for one basic reason: to enable the public to identify easily a particular product from a particular source.”); see also Kristen Knudsen, Tomorrow Never Dies: The Protection of James Bond and Other Fictional Characters Under the Federal Trademark Dilution Act, 2 VAND. J. ENT. L. & PRAC. 13, 20 (2000) (referring to “the traditional view of trademark protection as preventing a tort against the public, not a trespass onto the trademark itself”).
Customers have, however, no legal right to such protection. Only registrants are entitled to remedies for infringement or misrepresentation under trademark law. Consumers lack standing. Consequently, the owner of a trademark can allow unrelated persons to use the mark in a manner that creates a substantial likelihood of confusing customers.

To illustrate, KPMG LLP is a big five tax and accounting firm. In February 2001, it spun off a firm that took the name KPMG Consulting, Inc. These two firms are “completely separate” and “independent.” Neither owns the KPMG trademark. From the public record, they appear to be licensees from a common source. This joint use undoubtedly creates a substantial likelihood of confusion; the firms insist that they are independent but their trademark arrangement suggests they are not. Yet under current law, the trademark owner is the only one with the right to object.

From a systems point of view, confusing uses of trademarks are undesirable. They are no less so because one of the confusing users has authorized the other’s confusing use. Trademark owner liability would provide customers of either business with a remedy against the trademark itself. Joint uses would not be banned, and in fact might continue. But the owner of the trademark would become a guarantor of the users’ liability to their customers.

IV. STRATEGIC ANALYSIS OF THE PROPOSED SYSTEM

Proposals for changes in law-related systems should be accompanied by strategic analyses regarding the anticipated effects. Such analyses are

141. See James S. Wrona, False Advertising and Consumer Standing Under Section 43(a) of the Lanham Act: Broad Consumer Protection Legislation or a Narrow Pro-Competitive Measure?, 47 RUTGERS L. REV. 1085, 1098 (1995) (concluding that recent developments have brought most courts into agreement that consumers do not have standing to sue for misrepresentation, although various rationales are still employed).


144. See LoFucci, supra note 19, at 507–09 (describing strategic analysis and advocating its use in evaluating proposals for legal reform). For examples of strategic analyses of proposed legal reforms, see Lisa M. Bossetti & Mette H. Kurth, Professor Elizabeth Warren’s Article 9 Carve-Out
necessary because the effects of changes are seldom straightforward. In response to change, system participants devise and employ strategies designed to seek advantage under the new regime. The strategies of various participants often interact to produce results that are unintended, difficult to predict, or both. Strategic analysis enables the system manager to take into account not just the direct results of implementation of the change, but also the indirect results produced by strategy and strategic interaction. A strategic analysis can be generated interactively by role playing or simply through a thought experiment conducted by the analyst. At a minimum, the analysis should be reduced to writing to insure its internal logic.

Upon implementation of a trademark owner liability regime, strategically minded trademark owners could be expected to seek some means of avoiding the new liability. Removal of their trademarks from products and businesses would seldom be cost-effective. The value of trademarks in marketing greatly exceeds the liability trademarks would generate in the proposed regime. Removal of their trademarks from marginal products or businesses might be cost-effective for trademark owners. But that is not a problem because it would also be cost-effective for society as a whole. Society as a whole is best served when businesses are compelled to internalize the costs they generate and abandon ventures that generate more costs than benefits.

Alternatively, trademark owners might restrict use of their marks so that they did not identify the products or businesses with which they were used. For example, a minimart might present itself as a "business that sells Mobil products" or a keyboard manufacturer might present its product as a Bull HN keyboard "approved by Honeywell." This strategy too, would seldom be cost-effective. Trademarks would be considerably less effective if they simply endorsed rather than identified products or businesses. Nor would pursuit of an "endorsement" strategy for trademark owners necessarily be a bad thing for customers. Were it widely deployed, it would cause the appearance of the system of product distribution to better resemble reality. Customers could plainly see that particular trademark owners were not taking full responsibility for their products and outlets.

Yet another possibility is that trademark owners might respond by seeking greater control over the channels of distribution, perhaps replacing franchised

Proposal: A Strategic Analysis, 30 UCC L.J. 3 (1997), which provides a strategic analysis of a proposed change in creditor priorities, and Mark J. Roe, Corporate Strategic Reaction to Mass Tort, 72 VA. L. REV. 1 (1986), which analyzes a mass tort problem by examining strategies available to actors in the system.
146. See Frank H. Easterbrook & Daniel R. Fischel, Limited Liability and the Corporation, 52 U. CHI. L. REV. 89, 104 (1985) ("Externalization of risk imposes social costs and thus is undesirable.").
outlets with company-owned outlets. If the imposition of trademark owner liability had this effect, however, it would indicate that the displaced method of distribution had appeared "efficient" only because it enabled the trademark owner to externalize liability.

Another possible strategy would be for trademark owners to continue current patterns of trademark use, but to judgment proof themselves. A trademark owner might, for example, sell its marks to a wholly owned subsidiary that, after the purchase, would own no assets except the trademarks and the accompanying goodwill. That subsidiary would license the trademarks to other members of the corporate group, franchisees, and other outsiders. To assure that the courts would respect its separate identity, the corporation would have to charge reasonable royalties for the use of the trademarks, but most of the fees could be applied to the trademark acquisition debt or paid to the parent corporation as dividends.

As part of the transaction in which it acquired the trademarks, the corporation might be required to guarantee repayment of the corporate group's bank loans and secure both the bank loans and the acquisition loans with the trademarks. For most businesses, the amounts of the bank loans would exceed the total value of the trademarks. As a result, the trademarks would be fully encumbered.

If a licensee of one of the marks committed a tort and the victim obtained a judgment against the trademark-owning entity, the secured claim of the bank lenders would have priority over the judgment. To protect the value of their collateral, the bank lenders would have to foreclose. The bank would be entitled to choose the collateral against which it would foreclose. Acting in its own interest, it would choose the trademarks because they would be threatened by the judgment creditor. Governing law would require that the bank sell the trademarks at a public or private sale. In most cases, the trademark would have greater value to other members of the trademark owner's corporate group than to outsiders because the owner's group would continue to own the assets used in conjunction with the trademarks, while the outsiders would arguably have no

147. See, e.g., In re B.J. McAdams, Inc., 66 F.3d 931, 937 (8th Cir. 1995) (stating that "Directors cannot lawfully manage the affairs of one of the corporations in the interest of the other" (quoting Rounds & Porter Lumber Co. v. Burns, 225 S.W.2d 1, 3 (Ark. 1949)) (alteration in original)).

148. Prior to commission of the tort, such dividends would not be fraudulent transfers or otherwise illegal. See Steven L. Schwarcz, The Inherent Irrationality of Judgment Proofing, 52 STAN. L. REV. 1, 39 n.200 (1999) (acknowledging the legality of such dividends).


151. Those assets would not belong to the corporation that had trademark owner liability and would not be sold with the trademarks. In some circumstances, a competitor may be willing to pay more
right to use the trademarks at all. As a result, other members of the trademark owner's corporate group usually would be able to outbid outsiders. The customer's judgment would be discharged by the sale, the customer would recover nothing, and the marks would remain with the corporate group. Trademark owner liability would be defeated.

This vulnerability to judgment-proof entity structures is not unique to trademark owner liability. Elsewhere, I have demonstrated that virtually all liability is vulnerable to judgment proofing, and I have predicted the ultimate vulnerability of the current owner in order to eliminate the current owner from the market. Those circumstances are probably rare and may be constrained by antitrust considerations.

Purchase and use of the trademarks by outsiders would subject the marks to possible cancellation under the assignment-in-gross doctrine. See 15 U.S.C. § 10 (Supp. V 1999) (providing that "[a] registered mark . . . shall be assignable with the good will of the business in which the mark is used"). Although some erosion of the assignment-in-gross doctrine has occurred, see, e.g., Lemley, supra note 2, at 1710 ("[T]he trend in trademark law clearly seems to be toward permitting assignments in gross and 'naked,' or unsupervised, trademark licenses."). The doctrine retains at least some vitality. See, e.g., Pilates, Inc. v. Current Concepts, Inc., 120 F. Supp. 2d 286, 289 (S.D.N.Y. 2000) (holding a trademark abandoned because the owner had ceased business for a period of two years and, alternatively, that an attempted sale of the trademark was void because it was an attempt to assign the trademark in gross). But see Patterson Labs., Inc. v. Roman Cleanser Co., 802 F.2d 207, 208 (6th Cir. 1986) (holding a secured creditor entitled to the value of a trademark on default even though equipment used in the business had not been assigned to the secured creditor along with trademark).

Allison McDade argues that it might be practical for buyers of the trademarks to sell their own products under them. See Allison Sell McDade, Trading in Trademarks—Why the Anti-Assignment in Gross Doctrine Should Be Abolished When Trademarks Are Used as Collateral, 77 TEX. L. REV. 465, 477 (1998). She acknowledges, however, (1) some potential for confusion, see id. at 482, and (2) the need for a change in the law to permit such sales, see id. at 475–76.

To illustrate the circumstances of such a sale, assume that the trademarks have a value to the business of $100 million, the remaining assets of the business are worth $300 million, the bank loan (secured by the trademarks and assets owned by other members of the group) is $200 million and the judgment is for $50 million. The sale would discharge the bank's security interest in the trademarks and the claim of the judgment creditor against them. See U.C.C. § 9-617(a) (2001). The proceeds of the sale would be applied first to the bank's expenses in conducting the sale and then to the bank's loan. See id. §§ 9-615(a). Only if a surplus remained would the judgment creditor recover anything. The bank could bid up to $100 million to protect its interest in the trademarks, because it would know that the other members of the corporate group will be willing to purchase them for that amount. The bidding would probably stop at a considerably lower amount. It would then be in the interests of the bank to sell the trademarks to other members of the group because that would protect the bank's interest in its remaining collateral on the loan, and it would be in the interests of the other members of the group to buy them. Because each party would be acting in its own self-interest at each stage of the transaction, the arrangement need not be collusive. Absent collusion, the courts must uphold the transaction. See BFP v. Resolution Trust Corp., 511 U.S. 531 (1994) (holding that there is a conclusive presumption of reasonably equivalent value for purposes of Bankruptcy Code § 548(a) when the transfer is made through a noncollusive, regularly conducted foreclosure sale). Because the trademark would be fully encumbered, the judgment creditor would have to raise the full amount of its bid in cash. The judgment creditor could not profit from winning the bid because (1) the members of the corporate group would have no incentive to pay more than the $100 million value to buy the trademarks back from the judgment creditors, and (2) the bank would outbid the judgment creditor at any lesser amount.
mate failure of the liability system itself. Current law already honors a wide
array of judgment-proofing devices that, if used aggressively, could nullify
liability. Liability survives only because most businesses do not employ those
devices aggressively. Their reasons undoubtedly have more to do with the
anticipated cultural and political responses than with the anticipated legal
response. 155

I expect that the cultural and political limitations that prevent widespread
judgment proofing will disintegrate over time. Desperate businesses will
employ the judgment-proofing techniques first, and competitive forces will
compel others in their industries to follow. The soft judgment proofing in
widespread use today will gradually shift to harder modes that will defeat
liability entirely.

Trademark owner liability is, however, less vulnerable to judgment proof-
ing than are other forms of liability. The close relationship between a firm's
trademark and the firm's public image gives added force to the cultural and
political limitations on judgment proofing. When large, public companies
construct barriers against liability, they disguise and misrepresent them to the
public. 156 For example, owners of famous trademarks can, and do, distance
themselves from their failing affiliates. 157 But to distance one's business from its
trademarks in the eyes of the public is virtually impossible. To the public, the
trademark is the business. When a judgment entered against the owner of a
famous trademark remains unpaid, that unmistakably signals financial
irresponsibility to the public.

154. See LoPucki, supra note 23 (explaining the mechanisms by which the death of liability will
occur).
155. See, e.g., id. at 51–54 (discussing the cultural and political responses).
156. Consider, for example, the "ring fence" transaction in which PG&amp;E sought to insulate
its non-utility assets from the claims of creditors of Pacific Gas &amp; Electric, PG&amp;E's bankrupt pub-
lic utility subsidiary. When confronted on the issue by the Los Angeles Times, PG&amp;E's spokesman
contended that the purpose of the transaction was merely "to provide for a separate credit rating for the
parent company's other entities." See Maura Dolan, PUC Not Ready to Concede Its Rate-Setting
Authority to Judge, L.A. TIMES, Apr. 27, 2001, at A3 (citation omitted). The public was unlikely to
understand that the non-utility assets would receive a separate credit rating only because the ring fence
transaction appeared sufficient to defeat collection by the utility creditors.
157. For example, Iridium was founded by Motorola and for the first three years of its existence,
was a wholly owned subsidiary of Motorola, Inc. Even at the time of Iridium's bankruptcy, Motorola
controlled Iridium through its 18 percent stockholding. But on its website, Motorola described the rela-
tionship as follows:

"Q: What is Motorola's role in all this?
Iridium and Motorola are two separate companies. Motorola has a minority interest in
Iridium LLC (less than 20%) as an equity investor, and guaranteed some of Iridium LLC's debt."
Christopher M. Kwok, Parent Companies and Subsidiaries: Public Attention and Corporate Costs
(2000) (unpublished manuscript, on file with author). (The quoted material appeared at
http://www.motorola.com/satellite/info but has since been removed.)
CONCLUSION

The United States is committed to a system that distributes goods and services through markets. Markets can operate effectively only if market participants have the information they need to understand the choices they must make. As the American legal system currently operates, customers have no practical means for discovering the identities, entity structures, and financial responsibility levels of the persons with whom they deal. No practical means exist to provide that information. Customers make their market choices without that information, usually on the basis of trademarks. They learn the identities of the entities behind the trademark masks only when legal problems arise, and then it is too late. The result is market and system failure.

That failure can be remedied by holding trademark owners liable for the acts of authorized entities doing business under the marks, and for defective products identified by the marks. With such a rule in place, the information available to market participants—trademark information—would be sufficient to calculate, in a rough sense at least, the value of the liability offered. That is, customers enticed by a trademark would generally be aware of the trademark's prominence, and that prominence would serve as a rough proxy for the trademark owner's level of financial responsibility.

If trademark owner liability is imposed, most trademark licensors will likely respond by requiring their licensees to purchase adequate liability insurance and to indemnify the licensors against liability for the licensees' wrongful acts.\(^\text{158}\) Trademark owner liability will ultimately come to rest upon trademark owners only when, and to the extent, those owners select financially irresponsible licensees. Because trademark owners would be in a position to evaluate the entity structures and financial responsibility of their prospective licensees and to enforce the insurance and indemnification agreements, the result would be a functioning market for liability. Licensors would have incentives to consider the financial responsibility of their licensees, and licensees would have incentives to take closer-to-optimal levels of care and to provide closer-to-optimal levels of insurance.

Under the banner of "tort reform" the liability system has been under critical attack for more than two decades.\(^\text{159}\) The critics may be inclined to

\(^{158}\) See, e.g., Hanks, supra note 18, at 31 (stating that "vicarious liability comes coupled with the right to indemnification, and even if it did not, franchisors would require it as part of the franchise agreements").

oppose trademark owner liability as an expansion of what they see as a deeply flawed system. But, as I have noted elsewhere, governments have essentially only two methods for imposing social control: relatively subtle civil liability and relatively crude criminal incarceration. If civil liability is ineffective, governments will have to expand their use of criminal incarceration or abandon their efforts to enforce rights—including many kinds of property rights. Faced with this dilemma, even the harshest critics of the liability system call merely for the system’s reform, not its abolition.

For the liability system to survive, it must overcome its dependency on entity structure. Most customers do not deal with entities in any meaningful sense. They deal with trademarks. When invisible entity structures enable trademark owners to escape liability for those dealings, the effect is to judgment-proof the only significant actor on the scene—the trademark. If liability is imposed for insufficient reasons or tort verdicts are excessive, the governing rules of substantive law should be changed. But judgment-proof structures do not distinguish between excessive verdicts and reasonable ones, or between liability that is warranted and liability that is not. They defeat liability indiscriminately. Trademarks are the actors in our modern economy, and trademark owner liability is merely a proposal to make them responsible actors.

160. See LoPucki, supra note 23, at 3.
161. For example, enforcement of patent, trademark, and copyright rights are accomplished principally through civil liability. See, e.g., id. at 4.