

Think Consumer:
The Enforcement of the Trade Mark Quality
Guarantee Revisited, A Legal and Economic
Analysis

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By

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CAMBRIDGE
SCHOLARS

P U B L I S H I N G

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This book first published 2011

Cambridge Scholars Publishing

12 Back Chapman Street, Newcastle upon Tyne, NE6 2XX, UK

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

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ISBN (10): 1-4438-2686-3, ISBN (13): 978-1-4438-2686-0

For those who Left so Early, my Parents and others

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ACKNOWLEDGEMENTS

The author would like to thank Dr. Rachael Smith and Prof. Charlotte Waelde for helpful advice and comments.

INTRODUCTION

A trade mark facilitates consumer purchasing decisions among experience goods. It also encourages traders to produce and maintain quality products.¹ That is why trade mark protection is said to foster economic efficiency and thereby the production of quality goods as well as to (and deleted) reduce consumer search costs. Achieving these goals, however, requires that the traders of branded goods maintain a consistent quality across time and for all consumers.² The significance of quality maintenance is particularly evident in the case of marks with a reputation. Satisfaction on the basis of a reputation or an image should never become separate from the product to which the mark is attached.³ This could convert branded goods into status symbols even where such status does not necessarily match any real improvement in quality of the products to which the mark is affixed.⁴ In the short run, because consumers will be less interested in the quality and the price of the goods, the protection of the mark will excessively expand the monopoly power of the trade mark owner.⁵ In the long run, this could encourage traders to improve the advertising and persuasive value of their marks instead of maintaining and improving the quality of the product in question. This could severely undermine the economic benefits of trade mark protection.⁶

Despite its importance to consumers and the process of competition, the quality function is not properly protected. It is viewed as an economic

¹ W Landes, and R Posner, 'Trade Mark Law: An Economic Perspective' (1987) 30 J L and Economics 268- 271; N Economides, "The Economics of Trade Marks" (1988) 78 TMR 523- 532; M Pugath, *The International Political Economy of Intellectual Property Rights* (Edward Elgar, Cheltenham 2004) 36-34.

² Landes and Posner (n 1) 269- 270.

³ R Holzhauer, 'Jenever and Jumping Wild Cats' (2002) III The Economics of Intellectual Property 420; G Stigler, 'The Economics of Information' (1961) 69 J of Political Economics 213; Pugath (n 1) 36- 39; Economides (n 1) 523.

⁴ A Griffiths, 'A Law-and-Economics perspectives on trade marks' in L Bently, J Davis, and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 253.

⁵ Holzhauer (n 3) 415, 420; see in general R Smith and R Lusch, 'How Advertising can Position a Brand' (1976) 16 J of Advertising Research 37.

⁶ Pugath (n 1) 36- 39; Economides (n 1) 523.

function that may not be enforced under trade mark law.⁷ It has been argued that the importance of enforcing the quality function under trade mark law is unnecessary because a trader cannot risk reducing the quality of his branded goods without risking the loss of business. According to this view, market forces alone are sufficient to discipline traders who provide an inconsistent level of quality, and thus there is no need to enforce this function by law.⁸ Further, the concept of quality is heavily regulated under many legal norms such as consumer protection law which is believed to be better equipped to deal with such a matter. Consequently, the quality function of the trade mark is not seen as inherently worthy of protection.

It is against this backdrop that this book aims to tease out the different legal strands concerning the enforcement of the quality function, seeking both to analyse the current state of the law and to provide a reference point for potential problems and solutions as they arise. As such, it is pertinent to ask: why is it important to enforce the quality function of the mark? What is the legal nature of this function? Does trade mark law sufficiently protect the quality guarantee? Should this function be enforced under trade mark law? Why not? The reader must remember however that it is beyond the scope of this study to address all aspects of the enforcement of the quality function. That is why the protection of that function in the fields of unfair competition, comparative advertising and consumer law (as examples) will *not* be addressed.

This book is divided into five chapters and a conclusion. These can be viewed as two parts. The first (chapters 1-3) examines two major points. Firstly, it analyses the legal and economic rationales for trade mark protection. It underlines the importance of enforcing the quality function if trade mark protection is to promote competition and reduce consumer searching costs. Secondly, taking the economic and legal rationales of

⁷ Case 16/74 *Centrafarm v. Winthrop* [1974] 2 CMLR, para 22; Case I ZR 85/71 *Francesco Cinzano & Cie GmbH v Java Kaffeegeschäfte GmbH & Co.* [1974] 2 CMLR 21, para 11; Advocate General Opinion in Case C- 119/75 *Terrapin (Overseas) Ltd. v Terranova Industrie C. A. Kapferer & Co.* [1975] 2 CMLR 482 AG 490- 493; Advocate General Opinion Capotorti in Case 102/77 *Hoffmann-la Roche & Co. AG and Hoffmann-la Roche AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH* [1978] 3 CMLR 217 AG 6; *Scandecor Development AB v Scandecor Marketing AB & Others*, [2001] 2 CMLR 30; F Beier, 'Territoriality of Trademark Law and International Trade' (1970) 1 IIC 63. Beier contributed to the original proposal of the European Trade Mark Directive as an adviser to the Commission.

⁸ Landes and Posner (n 1) 268- 271; R Posner, *Economic Analysis of Law* (7th edn, Aspen Publishers, New York 2007) 370.

protection into account, part one provides an inside view as to whether or not the quality guarantee is properly protected under Article 5(1) and (2) of Directive 2008/95 (former Directive 89/104),⁹ (and Article 9(1) of Regulation 207/2009 (former Regulation 40/94)).¹⁰ In this regard, our discussion will be restricted mainly, but not solely, to the jurisprudence of the Court of Justice (the Court). On many occasions, the Court has considered the question of quality when determining the question of trade mark protection. Despite this fact, the Court's attitude concerning the enforcement of the quality function is far from clear.

Part two (chapters 4 and 5), firstly, critically reinvestigates the Chicago law and economics movement and its impact on the enforcement of the quality function under trade mark law.¹¹ The focus will be on highlighting the limitations of market forces in encouraging traders to maintain the quality of their goods as anticipated by the Chicago School. Keeping this in mind, chapter 5 then compares the scope of the satisfactory quality test that underpins section 14 (2) of the Sale of Goods Act as amended (as a leading example), with that of the quality guarantee under trade mark law. The goal is to investigate whether there is a quality regulation gap between consumer law and trade mark law.

Accordingly, chapter one provides an outline of certain background matters that will make the following chapters easier to follow. We begin by looking at the history and functions of trade marks with the quality function firmly in mind. We then examine the economic and legal rationales of trade mark protection. The focus will be on identifying the legal and economic contexts in which the protection of trade marks enhances the production of quality goods and reduces consumer search costs.

The second chapter considers whether the quality guarantee is properly protected under the doctrine of the trade mark subject-matter (under Article 5(1)). The aim is to build an accurate picture of how the principle of restricting the protection of the trade mark to its essential function should be implemented if trade mark protection is *not* to distort competition and artificially divide up markets between Member States. To this end, and building on our results in chapter one, we question whether, in principle, the enforcement of the origin function enhances competition *per se* or whether this depends on the ability of the trade mark owner to

⁹ Directive 89/104 has been repealed and replaced, with renumbering but no change of substance by Directive 2008/95 to approximate the laws of the Member States relating to trade marks [2008] L299/25.

¹⁰ [2009] OJ L 78/1.

¹¹ Landes and Posner (n 1) 268- 271; Posner (n 8).

maintain the quality of his/her branded goods. Put differently, this chapter investigates whether the act of not maintaining quality distorts competition and increases consumer search costs *even* if it is committed by the trade mark owner and how the Court of Justice has tackled such a concern. This serves as the starting point for assessing the legal possibility of requiring not only parallel traders but also trade mark owners themselves to maintain the quality of their goods. Taking international exhaustion as an example, we finally consider whether the enforcement of the quality guarantee under the essential function doctrine, and thus Article 5 (1), is biased toward traders.

In chapter three, we move on to consider the protection of the quality function under the dilution doctrine (under Article 5(2)). Given the fact that dilution is about protecting the investment of a trade mark owner, and thus the protection of consumers' interests as to quality issues is not a priority, this chapter examines whether reputable marks are granted too much protection and thus excessive monopoly. Considering the ECJ ruling in *Copad v Christian Dior*,¹² this chapter investigates the risks of *not* taking the broader legal and economic rationales for trade mark protection into account when expanding the protection of a trade mark's intangible aspects such as its selling power or reputation. To this end, chapter three critically scrutinises Schechter's argument that the uniqueness of the trade mark should constitute 'the only rational basis for its protection'.¹³ To test the sustainability of Schechter's notion of protection, we ask whether economic efficiency or trade mark efficiency should be the purpose of trade mark protection. Keeping the legal and economic rationales of trade mark protection in mind, this chapter highlights the importance of putting the concept of dilution in the context of the relationship between a trade mark's reputation and a product.¹⁴ This chapter also analyses the risk of doing otherwise and hence transforming consumers from being of a quality bias to become a brand bias. In this case, a trade mark becomes an anti-competitive tool. As such, despite the fact that dilution is mainly about protecting the investment of the trade mark owner, this chapter examines whether the question of quality maintenance must be taken into account when shaping trade mark protection under the dilution doctrine.

¹² C- 59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40, paras 24- 26.

¹³ F Schechter, 'The Rational Basis of Trademark Protection' (1927) 40 Harvard L Rev 831.

¹⁴ Case C-349/95 *Loendersloot v George Ballantine* [1998] ETMR 10, para 22; Case C- 10/89 *SA Cnl-Sucal v Hag*, [1990] 3 CMLR 571, para 13; Case C-427/93 *Bristol-Myer Squibb v Paranova* [1996] ETMR 1, para 43.

After exploring the significance of maintaining consistent quality and whether this function is protected under Article 5(1) and (2), we move on to investigate *why* the quality function is not sufficiently protected. To this end, chapter four critically examines how exactly the Chicago law and economics movement has come to the conclusion that consumers can rely on the proprietor of a trade mark having an economic interest in maintaining the value of his mark, and thus not to allow the quality of the goods sold under his banner to decline, which obviates the need for legal enforcement.¹⁵ The Chicago School or what we might call the Chicago ‘deregulation’ approach has profoundly influenced the enforcement of the quality function under trade mark law. That is why this chapter is dedicated to exploring two extremely important questions. Firstly, whether the Chicago approach to law and economics has exaggerated the role of market forces, and thus minimised the need for legal intervention to enforce the quality function under trade mark law. Secondly, whether the statement that trade marks always convey a consistent quality message is an accurate one.

The Chicago deregulation approach is based on a game-theoretic analysis used to predict the outcome of lawmaking using information about the preferences of individuals.¹⁶ According to this theory, policymaking is treated as a game of strategy.¹⁷ The Chicago model of quality enforcement is based on three assumptions: perfect competition, individual rationality and wealth maximisation. This chapter will investigate the interplay between these assumptions and quality maintenance. To assess the credibility of the Chicago hypobook, the chapter will consider whether seeking to retain long term profits means that traders will always maintain the quality of their goods. To clarify this point, practical examples including the latest financial crisis and the Toyota 2010 recall, will be used.

The concern as to the need for enforcing the quality function under trade mark law requires tackling a final question. Assuming that, despite its importance, the quality guarantee is not properly protected under Article 5(1) and (2) of Directive 2008/95 (and Article 9 (1) of Regulation

¹⁵ Landes and Posner (n 1) 268- 271; Posner (n 8).

¹⁶ C Camerer, *Behavioral Game Theory: Experiments in Strategic Interaction* (Princeton University Press, New Jersey 2003) 5; M Osborne, *An Introduction to Game Theory* (OUP, Oxford 2004) 1- 4; K Binmore, *Game Theory: A Very Short Introduction* (OUP, Oxford 2007) 2.

¹⁷ D Law, ‘Introduction: Positive Political Theory and the Law’ (2006) 15 J of Contemporary Legal Issues 1- 4; D Smith, J Banks, *Positive Political Theory I: Collective Preference* (Michigan University Press, Michigan 1999) 1- 25; Osborne (n 16) 1- 4.

207/2009) and that market forces are not a sufficient assurance that traders will not reduce the quality of their goods, this does not prevent the fact that quality issues are still heavily regulated under consumer protection law, particularly section 14(2) of the Sale of Goods Act 1979. Furthermore, when we say enforcing the quality function under trade mark law, what do we mean by quality? After all, apart from the concept of 'satisfactory quality', which underpins section 14(2), the term 'quality' cannot be clearly defined and thus measured, let alone enforced.

By investigating whether the rationale of quality regulation under trade mark law is different from that under section 14(2) of the Sale of Goods Act, the final chapter of this book tackles the above concerns. The quality of two satisfactory goods may vary significantly. Keeping this in mind, the focus in chapter five will be on whether the test of satisfactory quality reflects quality divergence between satisfactory and substandard goods *only* or if it counts *also* for quality differences between satisfactory goods. Recognising the difference between good and extra quality products requires identifying a standard or standards against which the concept of satisfactory or excellent quality can be measured. Given the number of goods available in the market however, this task is almost impossible. For this reason, in this chapter, *no* attempt will be made to define quality.

The concluding part of this book will show however that it is still possible to enforce the quality guarantee under trade mark law without the need to provide a clear definition as to what good or extra quality might mean.

Finally, during the course of writing this book, the Lisbon Treaty has come into effect. The European Court of Justice (the ECJ) is now referred to as the 'Court of Justice'. Trade Mark Directive 89/104 and Regulation 40/94 have been replaced by the codified version of Directive 2008/95 and the codified version of Regulation 207/2009 with renumbering but no change of substance. When dealing with cases already concluded, we will continue to refer to Directive 89/104 and Regulation 40/94 which were used by the ECJ (now the Court of Justice) in all the cases discussed in this work. We believe this makes life easier for the reader. However, when presenting our own argument, we will refer to the Court of Justice (the Court) and the new codified version of the Trade Mark Directive 2008/95 and Regulation 207/2009.

CHAPTER ONE

TRADE MARK PROTECTIONS: BACK TO BASICS

One of the most important functions of a trade mark is to enable the individual to identify a product as 'satisfactory and thereby to stimulate further purchases by the consuming public'.¹ The quality function signifies to a consumer that all goods bearing a given mark are of a certain quality. Trade mark protection is said to encourage traders to manufacture and sell quality goods and to provide information about those goods.² In order for that to work, marks must, on the one hand, be protected and, on the other, the traders must maintain the quality of their branded goods over time and for all consumers.³ While the scope of the protectable subject matter of the trade mark right has been constantly broadened, the quality guarantee is yet to be properly enforced.

This chapter is introductory. It lays the foundations for the discussion that follows. To this end, it provides a brief history of trade marks with particular reference to the role of the quality guarantee in the creation of the essential function of the mark, a badge of origin. Secondly, it considers the ways in which the legal protection of marks is justified. By examining the economic and legal rationales of trade mark protection, this part highlights the significance of enforcing the quality guarantee if the law is to achieve its goals. The chapter ends with an introduction to the legal background that informs and constrains trade mark functions in general and the quality guarantee in particular. This final part also serves as an introduction to the chapters that follow.

¹ F Schechter, 'The Rational Basis of Trademark Protection' (1927) 40 Harvard L Rev 818.

² W Landes, and R Posner, 'Trade Mark Law: An Economic Perspective' (1987) 30 JL and Economics 269- 271.

³ Ibid, 267- 269.

1. History of Marks

Examining the history of trade marks serves two intertwined goals. The first explains the roots and meanings of the social practices attached to the activity of affixing marks to goods. The second reflects the evolution of the law to illustrate the changes in the nature and scope of trade mark functions. Indeed, the change in the ways traders and consumers perceive the role of a trade mark has significantly influenced the development of the law to expand the scope and level of legal protection for trade marks.⁴ As we progress through this part, one fact will become apparent: the quality guarantee has played a significant role in the development of the origin function or what is known as the essential function of a trade mark.

1.1 The Early Phase

Anthropological and historical findings indicate that the use of trade marks in trade is as old as trade itself. Despite the fact that the legal protection of marks is fairly new, the concept of marking goods for various purposes predates written history. Examples of branding can be seen in cave paintings in South-Western Europe which depict branded animals, which might be traced back to the Stone Age and Early Bronze Era.⁵ The goals of these marking techniques, however, are constantly changing and are likely to remain a dynamic and changing field of legal debate.

1.2 The Proprietary Mark

Early trade marks were mainly used to protect personal property from theft and loss (the proprietary mark). Ancient cultures used small graphic

⁴ G Ruston, 'On The Origin of Trade Marks' (1955) 45 TMR 127, 128; for further information see F Schechter, *The Historical Foundations of the Law Relating to Trade-Marks* (Columbia University Press, New York 1925); see also T Drescher, 'The Transformation and Evolution of Trade Marks- from Signals to Symbols to Myth' (1992) 82 TMR 301, 309- 321; L Bently, and B Sherman, *Intellectual Property Law* (3rd edn, OUP, Oxford 2009) 711- 414.

⁵ Ruston (n 4); for further information see Schechter, (n 4); Drescher (n 4); W Cornish, and D Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights* (6th edn, Sweet and Maxwell, London 2007) 606; P Torremans, *Intellectual Property Law* (5th edn, OUP, Oxford 2008) 366- 371; J Davis, *Intellectual Property Law* (3rd edn, OUP, Oxford, 2008) 1- 20, 187- 191.

designs to brand livestock⁶ cattle⁷ and pottery.⁸ This technique served to identify the owner of the marked animals as well as to assist the illiterate who came into contact with the livestock. Despite the fact that the proprietary mark was not a trade mark in the modern sense, it set the stage for the development of modern trade mark law.⁹

The significance of the proprietary mark was further enhanced by the increase in trade in the ancient world.¹⁰ The act of selling and buying goods expanded over large areas, particularly in Egypt¹¹ and, in later stages, in the Roman Empire,¹² where traders had to travel long distances and in so doing exposed their goods to the risk of piracy and theft. But, branding techniques were not the only methods used to designate the ownership of animals or products. Other devices, such as monograms and heraldic tools, were also used.¹³

Branding for the sake of indicating property was not the only notable trade mark forerunner. Even at that early stage, marking practice was used to identify other aspects of a product, including but not limited to, the quality of materials and craftsmanship.¹⁴ According to Brian, the roots of this ‘quality’ factor can be traced back to the pre-historic era, approximately 6000BC, where examples of ‘quarry marks’ (marks used to indicate the source of the materials (stones) used in building) and ‘stonecutters’ signs’ (usually painted or carved into the stone) were discovered in building materials used in Egypt.¹⁵ Similar examples were also discovered in ancient buildings in Syria, Greece, Israel and Turkey. The Roman builder used a similar technique by stamping bricks or tiles to indicate the source and quality of the material used on the building or to

⁶ Schechter (n 4) 26; Bently and Sherman (n 4) 711- 713; D Kitchen and others *Kerly’s Law of Trade Marks* (14th edn, Sweet & Maxwell, London 2005); R Annand and H Norman, *Blackstone’s Guide to the Trade Marks Act 1994* (Blackstone Press, London 1994) 1- 32; E Rogers, ‘Some Historical Matter Concerning Trade Marks’(1910) 9 Michigan L Rev 29- 43; J Brian, ‘Historical Trademarks: In Use Since . . . 4,000 B.C.’ (2002) INTA Bulletin Archive.

⁷ Drescher (n 4) 301- 309.

⁸ Ruston (n 4).

⁹ Schechter (n 4) 34. Schechter argued that a proprietary mark is not a trade mark at 20.

¹⁰ Drescher (n 4) 309- 310.

¹¹ Ruston (n 4) 130.

¹² *Ibid*, 135.

¹³ Brian, Lohnes, &Albertson (n 6); Bently and Sherman (n 4) 711- 713; see also Kitchen and others (n 6); Annand and Norman (n 6).

¹⁴ Brian, Lohnes, & Albertson (n 6).

¹⁵ *Ibid*.

identify the person who made it or used it.¹⁶ This technique was important because some brick and tile makers used to wait for their goods to dry up for two or more years before sale. That is why the quality of these bricks was very good and it was important for the owner or the users of those bricks to identify this fact.¹⁷ In other words, the ancients were interested in ensuring the quality of goods or material by identifying the source (origin) or the maker of these materials. In that period, therefore, the quality of the goods was ensured by tracing its maker: its origin.

1.3 The Production Mark

With the rise of guilds during medieval times, trade marks were used for a different purpose. Guilds had control over who could make certain goods or provide certain services.¹⁸ Every trader or manufacturer was managed by a guild comprising a federation of master craftsmen. Guilds were also concerned with ensuring that the quality of their goods was satisfactory.¹⁹ To achieve this goal, guilds enforced their members to apply particular marks to their goods. Every trader was obliged to affix a certain mark to his goods, the one he obtained from the guild. This, in turn, allowed any sub-standard product to be traced back to its origin (its maker). Thus, the use of the production mark was compulsory to indicate the maker of the good in question.²⁰ The use of the production mark also helped guilds to ensure the dominance and monopoly of their businesses in a particular town or area. Guilds were able to identify and prevent foreign goods from being sold in their territories.²¹ This policy allowed guilds to enjoy an unchallenged trade monopoly in their local cities.²² At the same time, this meant that all trade marked products belong to the local guild and, at the same time, they were assumed to maintain some sort of production uniformity. Such a production control policy was a very important step from the buyers' perspective since it allowed them to have a very primitive 'medieval quality' function.²³ However, the rules of

¹⁶ Rogers (n 6) 29- 32; Brian, Lohnes, & Albertson, (n 6).

¹⁷ Ibid.

¹⁸ Schechter (n 4) 40, 78; Drescher (n 4) 311.

¹⁹ Bently and Sherman (n 4).

²⁰ Schechter (n 4) 38; Drescher (n 4) 311.

²¹ Ibid.

²² Schechter (n 4) 40; see also Drescher (n 4) 312, 313, 313- 320

²³ Ibid. In China, Greece and Rome marks were also used to convey information about, *inter alia*, the manufacturer of goods, ownership, source of materials, time of stamping and, in some cases, even the name of the trader who bought the

guilds were mainly intended to regulate the relationship between traders rather than to regulate the relationship between the traders and their customers.²⁴ During the medieval era, trade was mainly local. Traders usually kept a close relationship with their customers. This close proximity meant that customers did not have to rely on the production mark to check the quality of goods. They were in a good position to personally know the local trader and, therefore, to build reasonable expectations about the specifications of his products. That is why the role of the production mark in ensuring the quality of goods was not significant.²⁵

To sum up, in the medieval era the purpose of trade mark use was to enforce the rules of the guild which included, *inter alia*, monitoring the quality of the branded goods.²⁶ With the advent of the industrial revolution however, the concept of trade mark use had once again changed and to this we shall turn our attention.

1.4 The Modern Phase: The Interplay between the Quality and Origin Function

The advent of the industrial revolution had a significant impact on the development of trade mark functions. The economic wealth accumulated during the revolution gave marks a new role: they became national and international competitive tools. During the industrial revolution, some traders were able to produce goods in massive quantities. The use of canals and railways as efficient methods of transportation resulted in new methods of distributing goods.²⁷ In turn, this enabled traders to further expand their trade on local, national and international levels. This expansion of trade meant that traders started to sell their products outside their local areas. At the same time, they started to advertise their goods by reference to their trade marks.²⁸

Trading at national and international levels meant that consumers had access to a wider range of products imported from all over the world. Without being able to identify the source of those ‘foreign’ products, it

products and then sold them in other markets. The main objectives of providing this sort of information were to specify the source of goods, their origin, and their quality; see Rogers (n 6) 29- 33.

²⁴ Schechter (n 4) 40; Drescher (n 4) 311, 312, 313, 313- 320.

²⁵ Schechter (n 4) 41.

²⁶ Ibid, 40, 78.

²⁷ C Pickering, *Trade Marks in Theory and Practice* (Hart Publishing, Oxford 1998) 39.

²⁸ S Diamond, ‘The Historical Development of Trademarks’ (1975) 65 TMR 281.

was difficult to establish any idea about their quality.²⁹ To overcome this issue, purchasers started to rely on marks affixed to goods as indications of the source (the origin). As time passed by, consumers started to associate certain marks with particular manufacturers, and in turn a certain level of quality.³⁰ At this period, trade marks became indicators of origin and thus signs from which consumers could assume consistency of quality.³¹ According to Schechter, this change in the role of trade marks was first developed in the cloth and cutlery industries.³² It is in these industries where the 'evolution of the trade mark from a mark of origin to a mark of quality and hence from a liability to an asset' took place.³³ This important transformation was the result of using a particular municipality by some traders who had become known for their excellence and quality. Over time, this quality was identified and repeatedly purchased through the attached trade mark.³⁴ At this stage, consumers started to realise that some marks might indicate a desirable quality as well as the defects of the products to which they were attached.³⁵

1.5 Trade Marks as Marketing Tools

Around the beginning of the twentieth century, another important change in the role of trade marks took place. With the availability of a wide range of interchangeable products, traders started to advertise and package their products more often.³⁶ Reinforced by advertising, it is believed that, as time passed by, some marks became valuable assets in their own right.³⁷ They were able to convey some sort of emotional allure to consumers by virtue of their distinctiveness or appeal, not as a result of assumptions of origin or quality.³⁸ According to Drescher, it is thought that some marks were able to raise a desire for a product regardless of any assumed assumption about its quality. In doing so, the role of the trade marks changed from being indicators of origin (and thereby quality) to

²⁹ Drescher (n 4) 321; Pickering (n 27); Schechter (n 4) 129- 134.

³⁰ Ruston (n 4) 134- 135.

³¹ Schechter (n 4) 78.

³² Ibid, 79- 147.

³³ Ibid, 78.

³⁴ Ibid, 78- 79.

³⁵ Ibid, 79- 147.

³⁶ L Stephen, *Patents, trademarks and related rights: National and International protection* (Mass: Harvard Up, Cambridge 1975) 967.

³⁷ Ibid.

³⁸ Bently and Sherman (n 4) 712.

marketing tools.³⁹ This new role gave marks a profound competitive and commercial significance.⁴⁰ The change in the function of trade marks was described thus:

Take water and sugar: they are commodities. Process them into cola drinks, and you have products. Market and promote them into COCA –COLA and PEPSI- COLA: you have brands.⁴¹

Recently, trade marks have taken on a new function. Under this role, they provide consumers with an identity.⁴² When a consumer purchases an Ipod touch, for instance, he is actually buying an experience which helps to construct his identity. In this context, the trade mark becomes something much more than the product to which it is attached or its reputation for quality. Instituted through the presentation, marketing, advertising, and packaging, it becomes a brand, an image and a way of life.⁴³

2. Why the Quality Function?

A considerable amount of debate has been devoted to the question of trade mark functions. What are those functions and how much protection should they be given? There are a number of different aspects of this debate that have been explored in the academic literature. This book however focuses exclusively on one aspect: whether the enforcement of the quality function of the mark is in compliance with the underlying rationales for trade mark protection.

This part raises two related inquiries. First, how important is the quality function for both traders and consumers? Secondly (and closely related to the former point), why should marks be protected in the first place and why this protection relate to the quality guarantee? The importance of the quality function for consumers and traders is not difficult to ascertain. It enables a trader of branded goods to differentiate the quality of his goods from those of his competitors.⁴⁴ In this context, the

³⁹ Drescher (n 4) 301, 309- 321.

⁴⁰ Pickering (n 27) 38- 42.

⁴¹ *The Economist*, 'The Year of the Brand' 24 Dec. 1988, 101; Schechter (n 4) 129- 135.

⁴² Drescher (n 4) 301, 309- 321.

⁴³ J Litman, 'Breakfast with Batman: The Public Interest in the Advertising Age' (1999) 108 Yale LJ 1717.

⁴⁴ Landes and Posner (n 2) 269- 271.

protection of the trade mark is said to encourage the trader to produce and sell high quality products hence deriving economic efficiency. In the same way, the quality function enables a consumer to have expectations as to the quality of a given product. The consumer may rely on the trade mark's reputation to speed up a purchasing decision. This is said to reduce searching costs. In order for that to work, however, two conditions have to be established. First, a trader must maintain the quality of his branded goods over time and across consumers, otherwise the mark increases rather than decreases searching costs.⁴⁵ Second, the cost of searching for the right trade mark must be cheaper than the cost of searching for the desired attributes of the goods in question.⁴⁶ Promoting and maintaining consistent quality is what actually ensures that the protection of the mark does not enhance artificial product differentiation and artificial partitioning of markets.

However, we have already addressed that some marks became an asset by themselves through advertising, not through the quality of the product to which they are affixed.⁴⁷ This change is particularly important in the case of marks with a reputation where some marks have become a silent 'salesman' that could sell a product regardless of its origin or associated quality.⁴⁸ Such a new development raises concerns about the welfare of consumers and the wider policy of the law. If a consumer purchases a product because it is sold under a particular brand not because of its quality, the protection of the mark might increase artificial product differentiation, thus distorting competition and increasing rather than decreasing consumer searching costs. To clarify this point, two factors must be considered: firstly, we need to understand why marks are protected and the cost of this protection and, secondly, we need to identify the economic context in which this protection can be justified.

⁴⁵ Ibid, 267- 269; R Posner, *Economic Analysis of Law* (7th edn, Aspen Publishers, New York 2007) 391- 392.

⁴⁶ I Png, and D Reltman, 'Why are some products branded and others not?' (1995)38 JL and Economics 219.

⁴⁷ Page, 8.

⁴⁸ See in general Bently and Sherman (n 4) 714.

2.1 Why should Marks be Protected? Introduction

Trade mark protection can be justified on many grounds.⁴⁹ But one of the most persuasive arguments is that trade mark protection is justified insofar as it encourages traders and manufacturers to produce and sell high quality goods and to provide information to consumers about the attributes of those goods.⁵⁰ It is against this particular justification that this book aims to tease out the different legal strands concerning the quality guarantee and its implications for the development of the law.

The argument that trade mark protection encourages traders to produce and sell high quality goods and thereby reduces consumer searching costs is based on the idea that without trade mark protection there would be under-production of quality goods.⁵¹ Manufacturing a trademarked quality product costs time and money. The value of the mark in facilitating purchasing decisions depends on the information or reputation the mark conveys about the manufacturer of particular branded goods. Once the reputation of the mark is established, consumers will be willing to pay higher prices for the goods sold under the mark for greater assurance of consistent quality.⁵² However, replicating someone else's mark is easier and cheaper than creating a new one. The stronger the reputation of the mark is, the greater the temptation to duplicate it. Without legal protection, competitors can profit from the quality reputation consumers associate with the original mark by selling their own products under the mark for cheaper prices. If the products sold under a mark vary in quality, consumers will not be able to rely on it as a sign of consistent quality. In the long run, this will damage the reputation of the mark and, in turn, destroy it. This also means that the trader of trademarked quality goods (the investor) will not be able to recover his investment in the mark. In this context, protecting trade marks means enabling the investor to recoup his investment.⁵³ Thus, trade mark protection enhances the welfare of consumers by providing them with a greater range of quality products. At the same time, it fosters competition by enabling traders to recoup their

⁴⁹ For example, marks should be protected to prevent a third party from unjustly enriched by taking advantage of the mark or its reputation. Trade marks protection can also be justified under ethical grounds. *Ibid*, 4, 715- 721.

⁵⁰ Landes and Posner (n 2) 268- 273.

⁵¹ *Ibid*, 269- 271.

⁵² *Id*.

⁵³ *Ibid*, 267- 273.

investment and thereby encourages them to support the production of quality goods.⁵⁴

The protection of marks, however, is not cost free.⁵⁵ Trade mark protection enables the owner of trade mark rights an *exclusive* right to use his mark in certain cases. This exclusivity grants the owner of the mark a degree of monopoly over the use of this mark. The question of how much protection trade marks should be given depends on the cost of trade mark protection: the greater monopoly the exclusivity of a trade mark right generates, the more costly trade mark protection becomes. To this we shall turn our attention.

2.2 The Interplay between the Cost and the Scope of Trade Mark Protection

There is an inherent tension between the concept of trade mark protection, promoting competition and reducing consumer searching costs. Competition policy seeks to increase consumer welfare by fostering competition and, thereafter, maintaining prices at a marginal cost. Trade mark protection means granting a limited monopoly right to the owner of the mark. The problem is that the goals of promoting competition and reducing consumer searching costs are inherently inconsistent with the essence of branding goods.⁵⁶ After all, the notion that trade mark protection reduces searching costs is based on the theory of perfect competition. In a competitive market, it is assumed that information is needed for both traders and consumers. Information also can be transferred easily and accurately.⁵⁷ Hence, information about the price of a given product and its substitutes will be available for everyone. A trader in this case cannot increase the price of his/her branded goods as consumers may switch to similar but cheaper products.

By stark contrast, the idea of branding goods implies 'that products will be highly differentiated' and this differentiation is 'essential for their

⁵⁴ Id.

⁵⁵ E Chamberlin, *The Theory of Monopolistic Competition* (8th edn, Mass: Harvard University Press, Cambridge 1962); R Brown, 'Advertising and the Public Interest: Legal Protection of Trade Symbols' (1948) 57 Yale LJ 1165.

⁵⁶ G Ramello, 'What is in a Sign: Trademark Law and Economic Theory' (2006) 20 J Economic Surveys 556.

⁵⁷ R Whish, *Competition Law* (5th edn, Lexis Nexis, London 2003) 2.

ability to support detective meanings, identities or status attributes'.⁵⁸ Therefore, there is an unending tension between the goals of branding goods and enhancing perfect competition.⁵⁹ As one observer points out, a trade mark operates in two completely separate levels of distinctiveness which have to be considered.⁶⁰ On the first level, the mark tells a consumer about the existence and origin of a branded good identified by a certain trade mark or the so-called 'absolute' informational effect. At the second level, the mark encourages the consumers to perceive a particular branded good as different from all others similar substitutes. This is termed the 'differential informational effect'.⁶¹ This feature is usually referred to as the distinctiveness of a trade mark.

Let us take the Mercedes brand as an example. On the one hand, the mark Mercedes tells consumers that all cars sold under the mark are made by or, under the control of, Mercedes. On this level, the mark tells consumers about the origin or the source of Mercedes' cars. On the other hand, the mark also encourages consumers to perceive Mercedes' cars as different from all other similar or identical cars. As noted before,⁶² the distinctiveness of a mark (in this example Mercedes) is said to have a value that is not necessarily related to the origin or the quality of the cars sold under the mark Mercedes. In this case, it is the mark which sells the cars, and as a result, the quality of the cars sold under the mark becomes less significant. This, in turn, means that the Mercedes mark has moved from being a brand among other brands to being a brand that is better than all others brands. In this case, the cost of protecting Mercedes becomes high because it expands the monopoly power of the trade mark owner. Ramello observes that:

If the differential distinctiveness effect prevails, that specific sign [Mercedes] will take on for consumers a uniqueness that transforms it from a "sign among signs" to a "sign above other signs", a situation referred to as "salience" or "brand awareness" in marketing.⁶³

⁵⁸ J Aldred, 'The economic rationale of trade marks: an economist's critique' in L Bently, J Davis and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 278.

⁵⁹ Ramello (n 56) 556.

⁶⁰ Ibid.

⁶¹ Ibid, 557.

⁶² See pages, 8- 10.

⁶³ Ramello (n 56) 557.

Clearly, while a trade mark provides consumers with information about the origin of a particular product, it encourages them to believe that everything sold under the mark is unique in comparison with other substitutes available in the market. The latter minimises the role of marks in promoting competition and reducing consumer searching costs.

In a nutshell, trade marks protection might create deadweight costs such as monopoly or excessive competition. Reinforced through advertising, a trade mark could create a spurious image of high quality which deflects consumers from lower price substitutes of equal or even higher quality (in the present discussion, this could happen under the second level of distinctiveness or under the differential informational effect).⁶⁴

However, the question of distorting competition by generating monopoly depends, to a large extent, on how much market power the owner of the trade mark rights can exert. The question of exerting market power is closely related to the other question of how much protection marks should be given. The more market power a trade mark right generates, the wider the monopoly the owner of the trade mark right enjoys and the more costly trade mark protection becomes. That is why it is useful to examine whether the protection of marks generates monopolies.

2.3 Trade Mark Rights and the Question of Market Power

Generally speaking, the exclusive nature of a trade mark right does impose some costs. Examples include the costs of transferring, enforcing and, more importantly preventing others from using the same or similar signs.⁶⁵ As the scope of the trade mark subject matter increases, traders are increasingly enforced to seek different names, shapes or packaging for their goods. This imposes extra cost on all traders of branded goods, in particular the newcomers.⁶⁶ The question to be raised therefore: does the extra cost imposed on traders help the owner of trade mark rights to exert market power?

Trade mark law provides the owner of a trade mark right with control over the use of his mark in connection with goods or services. However, it must be remembered that the law does not give an exclusive control over the sale of particular goods or services. The act of granting an exclusive use to a trade mark itself does not generate a monopoly. To create a

⁶⁴ Landes and Posner (n 2) 274.

⁶⁵ Ibid, 273- 275.

⁶⁶ Bently and Sherman (n 4) 716.

monopoly, a trade mark must be treated in combination with the goods as a product in its own right.⁶⁷

The exclusive nature of a trade mark right and the extra cost it imposes, therefore, do not enable the owner of the right to exert monopoly power within a market.⁶⁸ The question of exerting market power has to be considered keeping in mind all types of identical or similar products which consumers might treat as substitutes. The question of whether a consumer will switch from one product to another if the price of the first is raised is everybody's guess.⁶⁹ This depends on a number of factors such as the advertising value of the mark⁷⁰, its selling power or reputation, the information available to the consumer and the way he utilises this information.⁷¹

Because of the lack of certainty as to the impact of the trade mark right in generating market power, it is very difficult to establish the proper scope of trade mark protection.⁷² One way out of this dilemma is to examine the best economic context in which the protection of the trade mark can be justified. By doing so, we identify scenarios in which the protection of marks is likely to promote or to distort competition. To this end, we need first to examine the economic role of trade mark law.

3. The Economic Role of Trade Mark Law

While we have already briefly addressed why trade marks should be protected,⁷³ this section introduces, with more details, some new issues yet to be considered. In this part, we ask four questions. The first three serve to identify scenarios where trade mark protection is less costly and thereby is less likely to have anti-competitive effects. The last question (question 4) identifies the context(s) in which trade mark protection is likely to have anti-competitive effects.

These questions are:

⁶⁷ P Behrendt, 'Trademarks and Monopolies: Historical and Conceptual Foundations' (1961) 51 TMR 853.

⁶⁸ Cornish and Llewelyn (n 5) 40.

⁶⁹ Ibid, 41.

⁷⁰ Id.

⁷¹ For information about the deficiency of consumers in utilizing information see A Tversky, and D Kahneman, 'Judgment Under Uncertainty: Heuristics and Biases' in D Kahneman, P Slovic, and A Tversky, (eds) *Judgment Under Uncertainty* (CUP, Cambridge 1982) 143.

⁷² Cornish and Llewelyn (n 5) 41.

⁷³ Page, 8.

1. What is the role of trade marks in promoting competition?
2. What is the role of trade marks in reducing consumer searching costs?
3. How much protection should be given to the quality guarantee and, in which context, if the protection of marks is to achieve its goals, i.e. promoting competition and reducing consumer searching costs?
4. What is the economic cost of protecting marks in gross?

3.1 The Role of Trade Marks in Promoting Competition

According to Chicago economists,⁷⁴ trade mark protection enhances competition by encouraging traders to manufacture and sell high quality goods thus deriving economic efficiency. Landes and Posner argue that a firm has an incentive to promote a trade mark only if it is able to maintain consistent quality.⁷⁵ In order for that to work however, trade marks must be protected and must not be duplicated. As this topic was dealt with previously, it is not necessary to look at it again here.⁷⁶ Instead, we will focus on the role of the quality guarantee in promoting competition. This can be explained by way of example.

Consider the following: a firm wants to promote a trade mark, say X. This requires spending a huge amount of money on issues such as maintaining and improving the quality of products sold under the mark, services and advertising. It is thought that the promoter of X mark is unlikely to develop and maintain a strong trade mark reputation unless he is able to maintain the quality of products sold under his mark.⁷⁷ This assumption is based on the idea that the lack of quality consistency will render the mark X useless. X's quality inconsistency means that it does not provide reliable information to consumers.⁷⁸ Hence, it does not facilitate their purchasing decisions. Given the fact that consumers pay more for branded goods in a clear exchange for a quality assurance, they will be unwilling to pay more for products sold under X mark than for the unbranded ones. If this happens, X's promoter will not be able to recover his investment in the mark. This by itself is said to discourage the owner of X mark to develop a trade mark reputation in the first place unless he is able to maintain the quality of goods sold under the mark.

⁷⁴ Landes and Posner (n 2) 265- 309.

⁷⁵ Ibid, 270.

⁷⁶ Page, 8.

⁷⁷ Landes and Posner (n 2) 270.

⁷⁸ Ibid.