

**Think Consumer; the Enforcement of the Trade Mark Quality Guarantee
Revisited. A Legal and Economic Analysis.**

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Submitted for the Degree of PhD

**The University of Edinburgh
2010**

For those who Left so Early, my Parents and others

Declaration

I declare that this thesis has been composed by myself, it is my own work and has not been submitted for any other degree or professional qualification.

Jamil Ammar

Acknowledgement

To Abir, the love of my life, thanks for your unwavering support. Thanks for putting up with me during the writing of this thesis. I just hope that you, like me, think it was worth it.

I also would like to thank my supervisors, Dr. Smith and Prof. Waelde who have offered a supervision that has been more than exemplary in every respect.

Abstract

The availability of a wide range of branded products makes the selection of the right type of good a difficult process. This is particularly true in the case of goods whose characteristics consumers do not have complete information about, which they can only learn about after purchasing (experience goods). A trade mark quality guarantee facilitates consumers' choice by sending quality signals. It also enables a trader of branded goods to differentiate the quality of his goods from those of his competitors. Accordingly, trade mark protection is said to enhance economic efficiency, and thus the production of quality goods, and reduce consumer search costs. In order for this to work, however, among other conditions, the trader must maintain consistent quality over time and across consumers. Otherwise, trade mark protection will enhance artificial product differentiation, and thus distort competition. To date, despite its profound significance, the quality guarantee is seen as performing an economic function that trade mark law is ill equipped to deal with. As a result, this function is not enforced under trade mark law.

Contrary to mainstream thinking, this thesis argues that the quality function of a trade mark should be recognised and enforced through trade mark law. What is at stake is far from insignificant: it is about bridging the ever increasing gap between the legal rationales for trade mark protection and the economic consequences of this protection in practice. The thesis is also about how consumers should shape their relationship with trade marks and what role law should play in constructing that relationship. By giving independent legal substance to the quality function, trade mark law encourages a trader to improve the quality of his goods instead of simply improving the persuasive or advertising value of the mark, which, in turn, enhances artificial product differentiation, increases rather than decreases consumer search costs, and distorts competition.

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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 function that may not be enforced under trade mark law.⁷ It has been argued that the importance of

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.

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*

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 thesis 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 thesis 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 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

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.

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

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).

depends on the ability of the trade mark owner to 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

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.

must be taken into account when shaping trade mark protection under the dilution doctrine.

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 hypothesis, 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.

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.

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 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 thesis 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 thesis 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 thesis, 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 PROTECTION: 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. 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

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.

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 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

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.

⁶ Schechter (n 4) 26; Bently and Sherman (n 4) 711- 713; D Kitchin 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).

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 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

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 Kitchin and others (n 6); Annand and Norman (n 6).

¹⁴ Brian, Lohnes, & Albertson (n 6).

¹⁵ Ibid.

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

¹⁷ Ibid.

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 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

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 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.

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 was difficult to establish any idea about their quality.²⁹ To overcome this issue, purchasers started to rely on marks

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.

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

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 marketing tools.³⁹ This new role gave

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.

³⁹ Drescher (n 4) 301, 309- 321.

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 thesis 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 protection of the trade mark is said to encourage the trader to produce and sell high quality

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.

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.

2.1 Why should Marks be Protected? Introduction

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, 14.

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

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 thesis 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.

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.

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

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, 14- 16.

among signs” to a “sign above other signs”, a situation referred to as “salience” or “brand awareness” in marketing.⁶³

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

⁶³ Ramello (n 56) 557.

⁶⁴ Landes and Posner (n 2) 274.

⁶⁵ Ibid, 273- 275.

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 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

⁶⁶ Bently and Sherman (n 4) 716.

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.

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:

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.

⁷³ Page, 14.

⁷⁴ Landes and Posner (n 2) 265- 309.

⁷⁵ Ibid, 270.

⁷⁶ Page, 14.

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.

The previous argument is best described by George Akerlof in his article 'The market for 'LEMONS'' where he argues:

There are many markets in which buyers use some market statistic to judge the quality of prospective purchases. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller. As a result there tends to be a reduction in the average quality of goods and also in the size of the market.⁷⁹

Akerlof highlights the interaction between quality heterogeneity, asymmetric information and the risk of producing low quality products.⁸⁰ Once a trade mark's reputation has been established, consumers will reward firms with a good reputation with a repeat purchase and punish those with a bad reputation by not buying their products. This is termed by Landes and Posner as a 'self-enforcing' feature of a

⁷⁷ Landes and Posner (n 2) 270.

⁷⁸ Ibid.

⁷⁹ G Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 QJ of Economics 488.

⁸⁰ Ibid.

trade mark.⁸¹ The impact of this switch policy is thought to encourage traders to maintain and improve the quality of their goods.

That is why trade mark protection is said to foster competition and thereby economic efficiency by encouraging traders to improve and maintain the quality of their branded goods.⁸²

3.2 The Role of Trade Marks in Reducing Consumer Searching Costs

In order to understand how a trade mark reduces consumer searching costs, imagine that you went to purchase a laptop made by Apple Macintosh and the latter had no brand name. In this case, you would have to ask for a laptop made by an American company called Apple Macintosh. To do this, you should remember first who made the laptop and its specifications. This requires you to remember a lot of information. Instead, you can simply ask for a MacBook13.⁸³ The task of purchasing a laptop becomes even more complicated if Apple Macintosh makes more than one type of laptop. An important purpose of trade marks is to associate easily recognizable and memorable names, such as MacBook13, with information relating to sellable products.⁸⁴ So, if you have a positive experience with Apple Macintosh and you want to buy the same laptop or a similar one or if another product made by Macintosh has been recommended to you by a reliable source, instead of investigating the attributes of all goods to determine which one is equivalent to what you want, you can simply choose a faster and less costly method by identifying the relevant mark and buying the corresponding product.⁸⁵

In other words, a trade mark summarises the specifications of a product in a few memorable words, such as MacBook13. The mark tells the consumer that the attributes of the branded goods are likely to be the same as that of the mark he

⁸¹ Landes and Posner (n 2) 270.

⁸² Ibid, 268- 271; N Economides, 'The Economics of Trademarks' (1988) 78 TMR 528.

⁸³ Landes and Posner (n 2) 268- 273.

⁸⁴ Ibid, 268- 271.

⁸⁵ Ibid, 268- 273.

enjoyed before. This is said to save the consumer time and money.⁸⁶ By identifying the source of a product and its quality, a trade mark enhances resource allocation through increasing consumer information and, therefore, reducing searching costs. Thus, the protection of trade marks is justified under the ground that it encourages ‘firms to produce products of desirable qualities even when these are not observable before purchase’.⁸⁷

3.3 The Importance of the Quality Guarantee in Promoting Competition and Reducing Searching Costs

As noted, trade marks perform a variety of economic functions.⁸⁸ Examples include the origin, quality and advertising function. This raises a question: is there a key function that without it the protection of trade marks would not achieve its economic goals? Put differently, can a trade mark perform exclusively as a badge of origin or advertising tool and still promote competition and reduce consumer searching costs? When making a purchasing decision, the consumer who wants to buy a quality product usually faces two choices. The first is to purchase an unbranded product and accepts the fact that this product might be cheaper, but its quality might not be guaranteed. Hence, he himself has to search to find unbranded yet reliable quality products.⁸⁹ Or the consumer can pay a premium for a branded good in exchange for an assurance of quality.⁹⁰ That is why the consumer whose time is valuable is likely to buy a branded product in a clear exchange for quality. In return for this time saving, he pays a premium.⁹¹ Consumer information theory reveals that where quality is a big concern, the consumer buys branded goods for premium grades.⁹² This is because trade marks convey valuable information about the quality of a product where quality is an important factor and where other sources of information are costly.⁹³

⁸⁶ Ibid, 269.

⁸⁷ Economides (n 82) 526.

⁸⁸ Pages, 8- 12.

⁸⁹ P Nelson, ‘Information and Consumer Behaviour’ (1970) 78 J of Political Economy 311.

⁹⁰ Ibid.

⁹¹ Png and Reltman (n 46) 219.

⁹² Ibid, 221; for general information see B Klein, and K Leffler, ‘The Role of Market Forces in Assuring Contractual Performance’ (1981) 89 J of Political Economy 615- 641.

⁹³ Png and Reltman (n 46) 223.

A trade mark is important, therefore, because of the reliability of information it conveys about the quality of a given product. Consumers perceive a trade mark as a sign of consistent quality. This consistency signal, nevertheless, can be conveyed through a trade mark reputation or its selling power. When a consumer purchases a branded good, he perceives the reputation of the mark or its selling power as a sign of honesty, reliability and, in some cases, technical efficiency. As time passes by, these priceless emotional aspects, the reputation of the mark or its selling power, might become the mark's strongest component which attracts the loyalty of consumers.⁹⁴

That is why if the trade mark is to remain an economically viable tool, the protection of the trade mark or its selling power must always be understood and linked to the specifications of the branded goods in question. Otherwise, the protection of the mark will enhance artificial product differentiation. After all, producing and maintaining a consistent quality product is what justifies the protection of a trade mark. Landes and Posner argue that trade marks reduce consumer purchasing errors *only* insofar as they denote consistent quality.⁹⁵

However, it has to be remembered that the trade mark does not solely function as a mere source of information as suggested by Landes and Posner.⁹⁶ Rather, it conveys many other messages that might negatively influence its original role and, therefore, upset its economic benefits.⁹⁷ These messages include creating a spurious image of singularity, reputation, social status or a prestigious way of life. If the decision of the consumer to purchase a branded good is mainly based on the quality of the product, the benefits of the mark in reducing searching costs is almost guaranteed. In this case, trade mark protection is less likely to increase artificial product differentiation. If the consumer chooses a product not only because of its quality but because of its

⁹⁴ I Callmann, 'Unfair Competition, Trademarks and Monopolies' (1981) at 36 cited in S Carter, 'The Trouble with Trademark' (1990) 99 Yale LJ 761.

⁹⁵ Landes and Posner (n 2) 269.

⁹⁶ Ibid, 274- 75.

⁹⁷ A Papandreou, 'The Economic Effect of Trademarks' (1956) 44 California L Rev 503; B Beebe, 'Search and Persuasion in Trademark Law' (2005) 103 Michigan L Rev 2043; Schechter (n 1) 831.

aura of luxury, as an example, the importance of the mark in reducing searching costs becomes less significant.⁹⁸

In a nutshell, trade marks may indeed perform a variety of functions. However, the economic benefits of trade mark protection can only be secured if the protection of the mark is related to its role in enhancing the production of quality goods. But as we explained before,⁹⁹ a few conditions have to be established if the benefits of trade marks are to be guaranteed.

4. Trade Mark Success: What are the Criteria?

The economic success of a trade mark in promoting competition and reducing search costs depends on three factors. Firstly, a consumer has to have a good memory to be able to recall the experience he associates with the mark in issue. Secondly, marks should be properly protected. Thirdly, the owner of the mark must maintain a consistent level of quality.¹⁰⁰

4.1 The Ability of a Consumer to Recall the Mark

In order for a trade mark to facilitate a consumer's purchasing decision, he has to have a good memory (an experience). Past experience helps the consumer to predict the likely outcome of a current consumption choice.¹⁰¹ If the consumer enjoys a product sold under the mark, he will purchase goods sold under the same mark again. Purchasing the goods sold under the same mark saves the consumer time and money where he does not have to investigate the attributes of all products he wants to purchase regularly. It could be argued that a fairly good memory is sufficient for the consumer to recall the mark and its associated features. Therefore, the vast majority of consumers qualify for this condition.¹⁰²

⁹⁸ For general information about the informative and influential role of marks see Papandreou (n 97) 504.

⁹⁹ Page, 22.

¹⁰⁰ Economides (n 82); W Landes, and R Posner, *The Economics Structure of Intellectual Property Law* (Harvard University Press, Cambridge 2003) 168.

¹⁰¹ Landes and Posner (n 2) 269.

¹⁰² Economides (n 82) 528- 529; Landes and Posner (n 2) 268- 270.

4.2 Legal Protection

The second condition for trade mark success is legal protection.¹⁰³ There is a wide range of evidence that indicates that marks are sufficiently protected. Under Directive 2008/95¹⁰⁴ (the Directive) and Regulation 207/2009¹⁰⁵ as well as national and international laws, trade marks enjoy a great deal of protection. As to the proper scope of this protection, however, the law does not always provide a clear answer.¹⁰⁶ The Directive evidently recognises the origin function of the trade mark so that consumers can differentiate the product of one undertaking from those of another undertaking.¹⁰⁷ The Directive also protects the mark with a reputation even where there is no risk of public confusion.¹⁰⁸ A close look at case law reveals a similar picture. On many occasions, the Court of Justice has increased the scope and level of trade mark protection. In *Davidoff v Gofkid* and later on in *Adidas-Salomon v Fitnessworld*,¹⁰⁹ the ECJ expanded the protection of the mark with a reputation in the case of similar and dissimilar goods and without the need to establish confusion. In *Arsenal Football v. Matthew Reed*,¹¹⁰ the ECJ made it clear that a third party's use of a sign which affects or is liable to affect the functions of the trade mark, in particular its essential function, may not be tolerated under Article 5(1) (a).

These are merely a few examples which indicate that trade marks are extensively protected. Expanding the scope of rights conferred on the trade mark owner has been one of the most significant developments of trade mark law. For some, the act of expanding the scope of trade mark rights has gone too far, to the extent that it has

¹⁰³ Economides (n 82) 528- 529; Landes and Posner (n 2) 268- 270.

¹⁰⁴ Directive 2008/95 to approximate the laws of the Member States relating to trade marks [2008] L299/25.

¹⁰⁵ Regulation 207/2009 on the Community trade mark [2009] OJ L 78/1.

¹⁰⁶ This is not to mention the numerous international treaties specifically governing the operation of trade mark law, including the Paris Convention, the Madrid Agreement and most importantly the Agreement on Trade-Related Aspects of Intellectual Property Rights of 1994, known as TRIPs.

¹⁰⁷ Article 5(1) (a) and (b) of Directive 2008/95 (n 104). TRIPs require all signatory countries to implement the internationally agreed minimum acceptable level of national trade mark protection, TRIPs, s 2, arts 15- 21.

¹⁰⁸ Article 5 (2) Directive 2008/95 (n 104).

¹⁰⁹ Case C- 292/00 *Davidoff & Cie SA and Zino Davidoff SA v Gofkid Ltd* [2003] 1 CMLR 35, paras 24- 26; Case C- 408/01 *Adidas-Salomon AG, Adidas Benelux BV v Fitnessworld Trading Ltd* [2004] ETMR 10, paras 18, 37- 40.

¹¹⁰ Case C- 206/01 *Arsenal Football Club plc v. Matthew Reed* [2003] ETMR 19, paras 48- 51.

been described as ‘the death of common sense’.¹¹¹ Given the increased expansion of the trade mark subject matter, some argue that trade mark law seems to confer ‘a form of quasi-copyright protection which protects traders rather than consumers’.¹¹²

4.3 The Protection of the Quality Function

The quality guarantee is enforced via the protection of the essential function of the mark, a badge of origin. On many occasions, the Court of Justice held that the essential function of the mark is to guarantee to consumers the origin of the goods.¹¹³ In *Intel v CPM*,¹¹⁴ the Advocate General pointed out that linking goods or services to a source of supply, whether the original producer or a commercial intermediary, is a *significant* function of a trade mark. Interestingly, the Advocate general used the word *significant* instead of *essential* to describe the origin function of the mark. This is important because soon after the *Intel* case, the ECJ expanded the scope of the trade mark’s essential function. In *L’Oréal v Bellure*, the UK Court of Appeal requested clarification as to the circumstances under which the trade mark proprietor can rely on Article 5(1) (a) of Directive 89/104 (replaced by Directive 2008/95) to prevent the use of his mark when such a use does not impair the essential function of the mark as a badge of origin.¹¹⁵ In particular, the ECJ was asked to issue a preliminary ruling on the application of the infringement criteria set forth in Article 5(1) (a) and (b) of the Directive. This request was submitted in connection with the use of L’Oréal’s mark on a so-called comparison list used by the defendant. The ECJ pointed out that a trade mark:

functions include *not only* the essential function of the trade mark, which is to guarantee to consumers the origin of the goods or services, *but also* its other functions, in particular that of guaranteeing the *quality* of the goods or services in question and those of communication, investment or advertising.¹¹⁶(Emphasis added)

¹¹¹ M Lemley, ‘The Modern Lanham Act and the Death of Common Sense’ (1999) 108 Yale LJ 1687.

¹¹² Bentley and Sherman (n 4) 915.

¹¹³ Case C- 48/05 *Adam Opel AG v Autec AG* [2007] ETMR 33, para 21 ; Case C- 245/02 *Anheuser-Busch Inc v Budejovicky Budvar narodni podnik* [2004] ECR I-10989, para 59.

¹¹⁴ Opinion of Advocate General E Sharpston in Case C- 252/07 *Intel Corp Inc v CPM United Kingdom Ltd* [2009] ETMR 13, AG 5.

¹¹⁵ Case C- 487/07 *L’Oréal SA v Bellure NV* [2009] ETMR 55.

¹¹⁶ *Ibid*, 58.

This is a clear recognition of the importance of the quality guarantee. However, there is a structural uncertainty in the law relating to the enforcement of that function. For instance, does the protection of the quality function through the origin one mean that the quality function is to be considered when addressing the scope of trade mark protection under the essential function of the mark? Or might it mean that the protection of the quality function comes into play not only when the origin function is affected but also when it is not? Considering the rulings of the ECJ in the field of parallel importation in general and in the *L'Oréal v Bellure* in particular, the latter interpretation seems more likely (the quality function should be protected against uses that do not necessarily affect the essential function of the mark). But even in the *L'Oréal v Bellure*, the ECJ did not explain how the quality function could be enforced. The ECJ could have created more legal certainty if it had given a more precise guideline in its decision regarding the ways to enforce the mark's other functions, in particular guaranteeing the *quality*. It remains to be seen whether this new interpretation could open the door for granting more legal substance to the quality guarantee. And it is here that the low-visibility issue of the connection between the form and scale of protection and what the law originally tries to protect come into play.

To sum up, apart from the quality function, it can be argued that trade mark functions are sufficiently protected. Hence, the second condition for trade mark success is also satisfied.

4.4 Maintaining Quality

The third condition and, probably, the most important aspect of trade mark success is the quality function.¹¹⁷ In fact, some argue that the quality guarantee is (by far) much more important than the origin one.¹¹⁸ A mark that only performs the origin function cannot be considered a trade mark after all. Schechter argued that 'marks

¹¹⁷ Landes and Posner (n 2) 268- 269.

¹¹⁸ See the United Nations Conference on Trade and Development (UNCTAD): *The Role of Trade Marks in Developing Countries*, (UNCTAD, New York, 1979) 1.

designating ownership are not trade-marks at all but merely proprietary marks, which may or may not incidentally serve to designate the origin or the source of the goods to which they are affixed'.¹¹⁹

The trade mark must convey a consistent quality message if the protection of the mark is to stay economically viable.¹²⁰ As noted, if the effect of artificial product differentiation that may result from trade mark protection is to be minimised, all protectable components of the mark including its selling power or reputation must also be linked in some shape or form to the quality of the branded goods.¹²¹ This is not to suggest that the mark should perform solely as a quality indicator. Rather, it is about highlighting the risk of protecting the reputation of the mark or its selling power regardless of the quality of the product to which it is affixed. In this case, instead of improving the quality of branded goods and thereby fostering economic efficiency, traders may introduce economically irrational elements to retain the loyalty of consumers, which may severely undermine the economic benefits of trade mark protection.¹²² Thus:

Where the reputation of a given brand-name product does not match its actual quality, it may lead consumers to commit “errors of commission”, that is purchasing the product on the basis of its inflated, or excessively favourable, pre-purchase assessment.¹²³

If a trade mark is to reduce consumers’ purchasing errors, its reputation must be equal to the actual value of the product in question. Otherwise, the mark will increase rather than decrease searching costs.¹²⁴ Accordingly, a trade mark is economically desirable *only* where it provides valuable information about the differences in quality of various products.¹²⁵ The lack of quality aspects, therefore, would mean that the mark creates an artificial differentiation between two almost identical products by providing information that is either irrelevant or confusing.

¹¹⁹ Schechter (n 4) 20.

¹²⁰ Landes and Posner (n 2) 268- 269.

¹²¹ Pages, 23, 31.

¹²² M Pugath, *The International Political Economy of Intellectual Property Rights* (Edward Elgar, Cheltenham 2004) 36.

¹²³ Ibid; see also (n 118) 7.

¹²⁴ Pugath (n 122) 37.

¹²⁵ Ibid, 39.

Providing reliable, meaningful and accurate information about quality is what really gives trade marks a true economic purpose.¹²⁶ Pugath argues:

A given trademark will function as an efficient indicator of quality as long as its reputation is balanced by its actual value. Trademarks cannot be considered efficient indicators of quality when the allocation of resources towards 'reputation', such as excessive advertising, is at the expense of good value.¹²⁷

Thus, if the protection of the mark including all its intangible elements, such as its selling power or reputation, is not linked to the quality of the product to which it is attached, the protection of the mark may enhance artificial product differentiation and artificial partitioning of markets. This is because it is easier for a trader to invest in the advertising value of the mark rather than to improve the quality of the product to which it is attached. If the role of the quality function is ignored, as time passes by, the advertising value of the mark would almost certainly increase at the expense of other much more economically viable elements such as the quality of the branded goods. Given the fact that enhancing economic efficiency and therefore the production of quality goods is what really justifies the protection of the mark, the protection of the quality guarantee should be the benchmark against which the success of the mark can be measured.

After examining the scenarios in which trade mark protection is less likely to distort competition and the conditions that have to be established if the benefits of marks are to be secured, we turn our attention to the last question in this part (question four).¹²⁸ This question identifies the economic context in which trade mark protection is likely to distort competition.

4.5 Trade Mark Protection in Gross: An Economic Analysis

Some argue that the intangible aspects of a trade mark such as its selling power or reputation should be protected separately from the product to which it is attached.¹²⁹

¹²⁶ Ibid, 39- 40.

¹²⁷ Ibid, 42.

¹²⁸ See page, 20.

¹²⁹ Schechter (n 1) 831.

According to this view, the protection of the mark can be economically justified on grounds other than enhancing the production of quality products. If the previous argument is economically sound, then it must be shown that protecting the intangible aspects of the trade mark benefits society and the process of competition.¹³⁰ Chicago economists Becker, Murphy and Glaeser adhere to the view that:

Trade marks can turn products into symbols of status even if this is not matched with any improvement in quality or other characteristic. Some neo-classical analysts have argued that this capacity contributes to social welfare through reducing the cost of satisfying a demand for social status.¹³¹

The previous argument is based on the George Stigler and Gary Becker principle, *de gustibus non est disputandum*.¹³² This principle means preferences are accepted at face value thus disagreements about matters of taste cannot be objectively resolved no matter what their content or origin.¹³³ Hence, it is partially impossible to establish whether consumers' preferences are wrong or whether their preferences can make them worse off. The direct result of this conceptual economic possibility is that we are unable to define what makes a consumer better off.¹³⁴ This is because it is difficult to question 'observed choices as running counter to true preferences, at least in all practical cases, since observed choices provide the only reliable information about preferences: they reveal preferences'.¹³⁵ This is because 'observed choices define preferences and preferences define what makes the individual better off'.¹³⁶

In the context of a trade mark-consumer relationship, this means that the mere willingness to pay a premium for branded goods means that consumers are better off even if they purchased a product under the persuasion of advertising, where branded goods are usually associated with artificial components and not with real and economically valued features.¹³⁷ According to this narrow interpretation, consumers

¹³⁰ Aldred (n 58) 273.

¹³¹ G Becker, and K Murphy, with E Glaeser, 'Social Markets and the Escalation of Quality: The World of Veblen Revisited in G Becker, and K Murphy, (eds) *Social Economics: Market Behaviour in a Social Environment* (Belknap press, Cambridge 2000) 97- 89.

¹³² G Stigler, and G Becker, 'De Gustibus Non Est Disputandum' (1977) 67 *American Economic Rev* 76- 90.

¹³³ *Ibid.*

¹³⁴ Aldred (n 58) 273.

¹³⁵ *Ibid.*

¹³⁶ *Ibid.*, 274.

¹³⁷ *Id.*

will be better off even if their desires have been satisfied through advertising rather than through improving the specifications of branded goods. In reality however, it is difficult to prove that consumers can benefit from paying for the intangible attributes of trade marks. A trade mark's intangible attributes such as its selling power or reputation might satisfy social needs (although economically speaking those needs are artificial) for some customers but, at the same time, they impose negative pressures on others.¹³⁸ The satisfaction of a customer for having a certain branded product that conveys social status is clearly outweighed by the dissatisfaction of those who are unable to have the same product. Thus, a trade mark's artificial attributes do not increase social welfare.¹³⁹ The argument to protect the mark regardless of its role as a quality indicator fails to appreciate the economic meaning of benefit. It is not healthy for social welfare to simply stimulate 'new wants and then satisfy them' since it is well-known that human 'happiness lies in narrowing the gap between what we have and what we want'.¹⁴⁰

Introducing artificial elements to a consumer-trade mark relationship enables traders to associate trade marked goods with mental images which in return enable them to compete in perception advertising. This creates three drawbacks for trade mark protection; as Economides puts it:

Competition in perception advertising may result in a larger number of brands at equilibrium than is optimal...The tie in produces an allocative distortion... Resources are wasted in the effort to link desired mental images with advertised goods.¹⁴¹

Therefore, from an economic point of view, if marks are to promote competition and reduce searching costs, the question of protection should always be linked to the economic value of the product in question.¹⁴² Otherwise, trade mark protection expands the monopoly power of the trade mark owner.¹⁴³ In some extreme cases,

¹³⁸ Id.

¹³⁹ Id.

¹⁴⁰ L Bruni and L Stanca, 'Income Aspirations, Television and Happiness: Evidence from the World Values Survey' (2006) 59 *Kyklos* 205.

¹⁴¹ Economides (n 82) 523.

¹⁴² R Holzhauser, 'Jenever and Jumping Wild Cats' (2002) III *The Economics of Intellectual Property* 415, 420; See in general R Smith and R Lusch, 'How Advertising can Position a Brand' (1976) 16 *J of Advertising Research* 37.

¹⁴³ Holzhauser (n 142) 420.

‘when the consumer buys everything which goes under the trademark, regardless of what product is covered by the trademark flag, at that point the trademark is turned into an anti-competitive weapon’.¹⁴⁴ That is why ‘satisfaction on the basis of goodwill or image of the producer should never become satisfaction with the producer, abstract from the products’.¹⁴⁵ Therefore the:

Process of the creation of the selling power of a brand should not... be translated into an exclusive right for the trademark owner, but should be left to the pressure of the competitive forces of the marketplace.¹⁴⁶

For this reason, in its memorandum on the Creation of a Common Market, the Commission pointed out that there are:

Objections to an extension of the exclusive right of the holder of a trade mark to protection against any other use, that takes place without a valid reason... Such a rule would entail that the monopoly of the legal owner would expand beyond the proper goal of the trade mark protection.¹⁴⁷

Considering the fact that enhancing economic efficiency and thus the production of quality goods is the main justification for trade mark protection, the enforcement of the quality function should be at the heart of the law. Furthermore, any expansion of trade mark protection must be implemented within the context of differentiating products and services and should not be granted to the selling power of the mark or its reputation unless these intangible aspects are clearly linked to the specifications of the branded goods in question.

After examining the economic role of trade mark law, our next task will be to investigate the legal justifications for trade mark protection.

5. Justifications for the Legal Protection of Trade Marks

¹⁴⁴ In this case, consumers become less sensitive to the lower prices, yet similar quality, of substitute products. This is because their loyalty is based on the mark rather than on the specifications of the products to which it is attached. The stronger the mark, the more it is immune from the competitive impact of price and quality competition and the less rational the consumers are. This in turn jeopardises the economic benefits of trade mark protection and distorts competition; *Ibid.*

¹⁴⁵ *Id.*

¹⁴⁶ G Stigler, ‘The Economies of Information’ (1961) 69 *J of Political Economics* 213; Holzhauser (n 142) 420.

¹⁴⁷ Memorandum on the Creation of an EEC Trade Mark adapted by the Commission on 6 July 1976, *Bulletin of the European Communities*, Supplement 8/76 at 72.

This part explores the legal context in which trade mark functions are protected. The question of trade mark protection has been hotly debated.¹⁴⁸ It concerns the context in which trade mark functions should be protected: should these functions be protected *per se* or should such a legal privilege rest on whether such a protection contributes to the broader economic objectives of the law itself (promoting competition and reducing consumer searching costs). The debate as to the goal of protecting a property is not new. Some eight hundred years ago the philosopher Thomas Aquinas argued that ‘positive right’ (*ius positivum*) can be considered fair and legitimate providing it contributes to general wellbeing.¹⁴⁹ Likewise, private property is fair providing that it enhances the interest of the public.¹⁵⁰ Thus, if we are to truly understand the policy underpinning trade mark protection, we should ‘go well beyond what one might call the “mere” right of property - the registered trade mark, or the goodwill - and the “mere” guarantee of origin’.¹⁵¹ As such, it involves balancing the ‘interests of the public in having a wide range of choice in products but also in not being deceived’ and, at the same time, the ‘interest of the producer or trader in preserving his goodwill’.¹⁵² In this thesis, we restrict our discussion to the role of trade mark protection in promoting competition and reducing consumer searching costs or what we might loosely call the ‘public interest’.

5.1. The Subject Matter of Protection

Trade mark protection should contribute to the process of competition. This view is in line with the explanations the European Commission provided for the establishment of the European trade mark system.¹⁵³ In its memorandum, the European Commission clarified the reasons behind the creation of a community

¹⁴⁸ Bently and Sherman (n 4) 714.

¹⁴⁹ Cited in C Geiger, ‘Constitutionalising’ Intellectual Property Law? The Influence of Fundamental Rights on Intellectual Property in the European Union’ (2006) 4 IIC 371.

¹⁵⁰ Ibid.

¹⁵¹ D Edward, ‘Trade Marks, Descriptions of Origin and the Internal Market’ (The Stephen Steward Memorial Lecture 2000) (2001) 2 IPQ 143- 144.

¹⁵² Ibid, 140. Recently, J Cornides has come to the same conclusion, upholding the role of intellectual property in promoting public interest stating that ‘the most important conclusion to be drawn... is that property is not an end in itself. Obviously, it must be used in a way that contributes to the realisation of the higher objectives of human society’; J Cornides, ‘Human Rights and Intellectual Property, Conflict or Convergence?’ (2004) 7 J of World Intellectual Property 145. A counter argument however can be found under Article 345 (ex Article 295) of the Consolidated Version of the Treaty on the Functioning of the European Union [2008] OJ C 115/47; hereinafter referred to as the Treaty.

¹⁵³ Memorandum on the Creation of an EEC Trade Mark (n 147).

system of trade mark law and its main objectives. The Commission made it clear that when determining the legal form of the law, the objectives of the EU Treaty must be born in mind (Replaced by the Consolidated Version of the Treaty on the Functioning of the European Union, TFEU).¹⁵⁴ In accordance with Article 3 (3) (ex Article 2) of the Treaty on the European Union (TEU), the Union has the task of promoting, *inter alia*, ‘sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy’. Article 3 also calls for the establishment of the internal Market.¹⁵⁵ This goal was further emphasised by the preamble of the TFEU which calls for the abolition of obstacles between Member States to ‘guarantee steady expansion, balanced trade and fair competition.’¹⁵⁶ The protection of trade mark is said to facilitate the achievement of these goals by enabling consumers to differentiate the product of one undertaking from those of other undertakings.¹⁵⁷ The Commission then went on to argue that:

[T]o an economic system directed towards the needs of consumers, trade marks are thus indispensable. They play an important role in the public interest in the distribution of goods and services, and should therefore be given legal protection.¹⁵⁸

The Commission came to the conclusion that the lack of a uniform system of trade mark protection throughout the Community would have a harmful impact on both traders and consumers.¹⁵⁹ A Community trade mark system, therefore, was likely to have a positive impact on both the creation of a free market for goods and, at the same time, could ensure fair competition as required by the Treaty.¹⁶⁰ An EU trade mark system would contribute substantially to the harmonious development of economic activities, and a continuous and balanced expansion of the standard of living in the Community.¹⁶¹

¹⁵⁴ Ibid, para 8; see the Treaty (n 152).

¹⁵⁵ The Consolidated Version of the Treaty on European Union [2008] C 115/13.

¹⁵⁶ Memorandum on the Creation of an EEC Trade Mark (n 147) para 9; see also recital 3 of the Treaty (n 152).

¹⁵⁷ Memorandum on the Creation of an EEC Trade Mark (n 147) paras 10- 12.

¹⁵⁸ Ibid, 13.

¹⁵⁹ Ibid, 17- 18.

¹⁶⁰ Ibid, 24.

¹⁶¹ Ibid, 25.

Therefore, the fundamentals of a trade mark system should be implemented keeping the objectives of the TFEU firmly in mind. To this end, trade mark law must serve all related parties, including consumers.¹⁶² Further, in order to sustain the stated objectives of the Treaty,¹⁶³ the trade mark system must:

[B]e based on the unitary and autonomous character of the EEC trade mark, and includes rules which guarantee the free movement of goods and so promote competition between products marketed by the owner of the trade mark or marketed with his agreement.¹⁶⁴

Finally, the European trade mark system must be effective and modern to accommodate the interests of the public and traders alike.¹⁶⁵ Trade marks, therefore, can be considered one of the important tools for the achievement of the objectives of the Treaty. They are considered an essential part of undistorted competition.¹⁶⁶

In a nutshell, the aim of trade mark protection is to stimulate competition between suppliers of goods and services to the consumer's advantage in the Community by allowing competitors to highlight objectively the merits of the various comparable products while, at the same time, prohibiting practices which may distort competition, be detrimental to competitors and have an adverse effect on consumer choice.

5.2 Trade Marks as Essential Elements of a System of Undistorted Competition

From the preceding part,¹⁶⁷ we concluded that trade mark protection is mainly intended to promote competition and thereby the interest of consumers. The Trade Mark Directive 2008/95 and Regulation 207/2009 support such an interpretation. The preamble of the Directive provides that the goal of trade mark protection is to promote competition within the Union.¹⁶⁸ Recital two of the Regulation provides that

¹⁶² Ibid, 52, 53.

¹⁶³ The objectives can be found in Article 3 of the TFEU (n 152).

¹⁶⁴ Memorandum on the Creation of an EEC Trade Mark (n 147) para 45.

¹⁶⁵ Ibid, 55- 56.

¹⁶⁶ Case C- 10/89 *SA CNL-Sucal Nv v Hag GF AG* [1990] ECRI 3711; Case C- 517/99 *Merz & Krell GmbH & Co's Trade Mark Application* [2002] ETMR 21, para 21.

¹⁶⁷ Pages, 34- 38.

¹⁶⁸ Directive 2008/95 (n 104).

barriers to free movement of goods and services should ‘be removed and arrangements be instituted which ensure that competition is not distorted’.¹⁶⁹

On many occasions, the Court of Justice has held that trade mark protection enhances competition.¹⁷⁰ In *HAG II*, the ECJ upheld the role of marks in a system of undistorted competition. The ECJ pointed out: ‘with regard to trade mark rights, it should be observed that such rights constitute an essential element of the system of undistorted competition which the Treaty aims to establish and maintain’.¹⁷¹ The ECJ added that undertakings should attract and retain the loyalty of customers by the quality of their goods and services.¹⁷² This could only be made possible by means of distinctive signs which allowed them to be identified, the ECJ added.

In *Merz*,¹⁷³ the ECJ came to the same conclusion. More importantly, the ECJ pointed out that traders may gain consumers’ loyalty by the quality of their goods and it is here where the exclusivity of trade mark rights can be justified. The ECJ pointed out that:

...trade mark rights constitute an essential element in the system of undistorted competition which the Treaty is intended to establish. In such a system, undertakings must be able to attract and retain customers by the quality of their products or services, which is made possible only by distinctive signs allowing them to be identified.¹⁷⁴

Thus, the essence of trade marks protection is to enable traders to differentiate the quality of their branded goods and thereby promote competition. This goal is a key factor in justifying trade mark protection.

Recently, the Court of Justice emphasised the need for balancing trade mark rights in a way that enables the mark to fulfil its essential role in the system of undistorted competition which the TFEU seeks to establish and maintain.¹⁷⁵ Striking such a

¹⁶⁹ Regulation 207/2009(n 105).

¹⁷⁰ *CNL-Sucal v Hag* (n 166) para 13.

¹⁷¹ *Ibid.*

¹⁷² *Id.*

¹⁷³ *Merz & Krell* (n 166) para 21.

¹⁷⁴ *Ibid.*

¹⁷⁵ Case C- 102/07 *Adidas AG v Marca Mode CV* [2008] ETMR 44, para 45; see also C- 228/03 *Gillette Co v LA-Laboratories Ltd Oy* [2005] ECR I-2337, para 29.

balance however is not straightforward. This task depends, to a great extent, on the protection of trade mark functions, in particular the quality guarantee. As already explained, despite its role in promoting competition and reducing consumer searching costs, the quality function is yet to be properly protected.¹⁷⁶

5.3 Whose Interest should be Taken into Account when Shaping Trade Mark Protection: The Trader, the Consumer or Both?

Trade mark law is clearly trader-centred. Does this mean that the interest of consumers under the law is a secondary consideration? The answer is no. The influence of the interests of consumers on the development of trade marks is clearly noticeable.¹⁷⁷ That is why the interests of consumers should be taken into account when considering the question of trade mark protection. The first recital of Directive 2008/95 (the Directive) pays special regard to the ‘Treaty establishing the European Community and in particular Article 95 (now Article 114 TFEU) thereof’.¹⁷⁸ The introduction of Article 114 (ex Article 95) was a giant leap towards recognizing the interests of consumers under the Treaty. The Commission stressed the point that the approximation of laws affecting the internal market must be based on a high level of consumer protection. Article 114 (3) reads:

The Commission, in its proposals envisaged in paragraph 1 concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. Within their respective powers, the European Parliament and the Council will also seek to achieve this objective.

Article 114, however, is not the only Article that emphasises the importance of recognising the interests of consumers under the TFEU. Other legal provisions such as Articles 5 (1) of the TEU and 12 of the TFEU (ex Article 153 (2) EC) have major implications in that direction. Article 12 reads: ‘consumer protection requirements shall be taken into account in defining and implementing other Union policies and activities’.

¹⁷⁶ Page, 27.

¹⁷⁷ Pages, 8- 12.

¹⁷⁸ Directive 2008/95 (n 104).

Hence, recognising the interests of consumers in general is key to achieving the objectives of the Treaty on the Functioning of the European Union as stated in Article 3. Recognising these interests under the Directive is a step in the correct direction. Indeed, the Directive is an essential part of the approximation process outlined in the Treaty and, therefore, should be interpreted accordingly. The main objective of the harmonisation process initiated under the Treaty is to strengthen competition and public interest since it is understood that fragmentation might not be in the consumers' best interests¹⁷⁹ and this is particularly true in the case of the law of trade marks.¹⁸⁰ Hence, the interests of both consumers and traders should be taken into account when shaping the scope and form of trade mark functions.

6. Does the Quality Function have a Place under Trade Mark Law?

Considering the importance of enforcing the quality guarantee in promoting competition and reducing consumer searching costs,¹⁸¹ a question should be raised: does trade mark law provide an exclusive list of functions that trade marks should or should not perform? Next we examine the protection of trade mark functions under the law.

6.1 Trade Mark Protection: The Law

Under Directive 2008/95 (the Directive) and Regulation 207/2009 (the Regulation), the definition of trade mark functions can be interpreted in different ways. Article 2 of the Directive (corresponding to Article 4 of the Regulation) sets out the fundamental criteria required for a sign to be registered by describing the mark as any sign capable of being represented graphically.¹⁸² Examples include, words, designs, letters, numerals the shape of goods or of their packaging: as long as these signs are capable of distinguishing the products or services of one undertaking from

¹⁷⁹ See in general Articles 2, 3, 5, and 26 (ex Article 14) of the TFEU (n 152).

¹⁸⁰ Memorandum on the Creation of an EEC Trade Mark (n 147) paras 17- 18.

¹⁸¹ Pages, 14- 23, 31.

¹⁸² Directive 2008/95 (n 104); for general information about the Directive and Regulation see S Maniatis, and D Botis, *Trade marks in Europe: a practical jurisprudence* (2nd edn, Sweet & Maxwell, London 2010) 3- 7, 344- 350.

those of other undertakings.¹⁸³ Recital 11 of the Directive provides that a trade mark may perform a variety of functions. It reads:

...the protection afforded by the registered trade mark, the function of which is *in particular* to guarantee the trade mark as an indication of origin, is absolute in the case of identity between the mark and the sign and goods and services; whereas the protection applies also in case of similarity between the mark and the sign and the goods or service.¹⁸⁴ (Emphasis added)

The use of the word ‘in particular’ can be interpreted as meaning that the Directive does not provide an exclusive list of functions trade marks can perform.¹⁸⁵

Article 5 of the Directive (and the corresponding provisions of the Regulation) sets out the rights of a trade mark proprietor.¹⁸⁶ Article 5 reads:

1. The registered trade mark shall confer on the proprietor exclusive rights therein. The proprietor shall be entitled to prevent all third parties not having his consent from using in the course of trade:
 - (a) any sign which is identical with the trade mark in relation to goods or services which are identical with those for which the trade mark is registered;
 - (b) Any sign where, because of its identity with, or similarity to, the trade mark and the identity or similarity of the goods or services covered by the trade mark and the sign, there exists a likelihood of confusion on the part of the public, which includes the likelihood of association between the sign and the trade mark;
2. Any Member State may also provide that the proprietor shall be entitled to prevent all third parties not having his consent from using in the course of trade any sign which is identical with, or similar to, the trade mark in relation to goods or services which are not similar to those for which the trade mark is registered, where the latter has a reputation in the Member State and where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark.¹⁸⁷

Next we explain these provisions with more details.

6.2 Trade Mark Protection under Article 5(1) of Directive 2008/95

¹⁸³ Ibid.

¹⁸⁴ Recital 11 of Directive 2008/95 (n 104).

¹⁸⁵ H Norman, ‘Time To Blow The Whistle On Trade Mark Use’ (2004) 1 IPQ 1- 34.

¹⁸⁶ Article 5 of Directive 2008/95 (n 104).

¹⁸⁷ Ibid.

Article 5(1)(a) confers on the proprietor of a trade mark the right to prevent all third parties from using an identical sign to the trade mark in relation to goods or services which are identical with those for which the trade mark is registered. In this case, the protection afforded to the mark is absolute. Under Article 5(1)(a), many factors have to be taken into account before establishing a successful infringement claim. The mark must be used in the course of business in relation to the goods or the services in issue.¹⁸⁸ Further, the conflicting marks must be identical. The goods or services also must be identical.

Under Article 5(1)(b), if the sign is similar to a trade mark and is used in relation to goods or services which are identical or similar to those for which the mark is registered, the test of confusion has to be established.¹⁸⁹ Recital 11 of the preamble of the Directive 2008/95 provides that the appreciation of confusion test depends on:

... numerous elements and, in particular, on the recognition of the trade mark on the market, of the association which can be made with the used or registered sign, of the degree of similarity between the trade mark and the sign and between the goods or services identified.

The likelihood of confusion must therefore be appreciated globally, taking into account all factors relevant to the circumstances of the case.¹⁹⁰

It has to be recognised that the owner of a registered mark enjoys an absolute right to prevent competitors from using his sign. Infringement might occur regardless of the “knowledge, the intention or the derivation” of the infringers.¹⁹¹ The owner also does not have to establish damage on his part since he enjoys the right to establish a successful infringement claim although his registered mark has not been used.¹⁹²

As to the scope of trade mark protection under Article 5, the Commission has repeatedly stressed the importance of interpreting the law strictly. Trade mark

¹⁸⁸ See in general *Arsenal Football v Reed* (n 110); *Adam Opel v Autec* (n 113) para 23; *Adidas v Marca Mode* (n 175) para 34; Case C- 533/06 *O2 Holdings v Hutchinson* [2008] 3 CMLR 14.

¹⁸⁹ Article 5(1) (b) of Directive 89/94 (n 104); Case C-120/04 *Medion AG v Thomson Multimedia Sales Germany & Austria GmbH* [2005] ECR I-8551, paras 24, 26.

¹⁹⁰ Case C- 251/95 *Sable BV v Puma AG* [1997] ECR I-6191, para 22; Case C- 425/98 *Macra Mode v Adidas* [2000] ECR I-4861, para 40.

¹⁹¹ L Bently, and B Sherman, *Intellectual Property Law* (3rd edn, OUP, Oxford 2009) 916.

¹⁹² *Ibid.*

protection should not unduly hamper competition. Applying a restricted approach when interpreting the law would be in the interests of the proprietor, who might be a defendant or plaintiff, his competitor and the consumer.¹⁹³

6.3 Trade Mark Protection under Article 5(2) of Directive 2008/95

Article 5(2) of Directive 2008/95 permits Member States to provide extra protection for marks with a reputation.¹⁹⁴ Under this Article, the mark is protected for its distinctive character including its reputation.¹⁹⁵ Under Article 5(2), preventing public confusion as to the source of goods might not be the first priority. The first priority is to protect the goodwill of the mark. Article 5 (2) provides protection for the identity of the mark. It is intended to prevent the dilution of a trade mark's value regardless of consumer harm.¹⁹⁶ Hence, confusion is not required. That Article is a clear recognition of the fact that the function of the mark with a reputation is much more complicated and symbolic than a mere badge of origin.¹⁹⁷ The interpretation of Article 5 (2) however is not straightforward. It requires the act of trade mark use to take unfair advantage of, or to be detrimental to, the distinctive character or repute of the mark.

The ECJ extended the protection of Article 5(2) even in the case of similarity between marks attached to goods or services. The ECJ has repeatedly stated that Article 5(2) must be invoked against competitors. The ECJ held that:

Where a Member State exercises the option provided by Art.5 (2) of the Directive, it must grant to the proprietors of marks with a reputation a form of protection in accordance with that provision.¹⁹⁸

The ECJ justified its decision stating that Article 5(2) must cover both similar and dissimilar goods and services, otherwise famous marks will be treated less favourably in the case of similar goods than in the case of dissimilar.

¹⁹³ Memorandum on the Creation of an EEC Trade Mark (n 147) paras 68- 70.

¹⁹⁴ *Adam Opel v Autec* (n 113) para 33.

¹⁹⁵ See in general *Adidas v. Marca Mode* (n 195) paras 40- 45.

¹⁹⁶ R Peritz, 'Competition Policy and its Implications for Intellectual Property Rights in the United States (2007) in S Anderman (ed.) *The Interface between Intellectual Property Rights and Competition Policy* (CUP, Cambridge 2007) 168.

¹⁹⁷ C Seville, *EU Intellectual Property Law and Policy* (Edward Elgar, Cheltenham 2009) 211.

¹⁹⁸ *Adidas-Salomon v Fitnessworld* (n 109) para 18.

Some argue that the ECJ has missed the essence of anti-dilution law by expanding the scope of Article 5 (2). The aim of the dilution provisions is to provide extra protection for reputable marks only where the test of confusion is difficult to establish. Therefore, if the ECJ wants to expand the scope of Article 5(2), it should expand the scope of the confusion test as well. MacCarthy argues that:

Marks with a “reputation” do not receive “less” protection under the explicit language of Directive Articles 4(4) (a) and 5(2) they receive *more* protection. When the goods or services of the contesting parties are competitive or similar, then the traditional confusion-based rules apply to their broadest and most robust extent. If the mark is so strong as to have a “reputation”, then in cases of competitive or similar goods or services that mark should have no difficulty prevailing under the traditional confusion-based rule of law. There should be no need to switch gears and invoke the extraordinary remedy of an anti-dilution law.¹⁹⁹

Cornish and Llewelyn describe the attitude of the Court of Justice regarding the expansion of the scope of Article 5 (2) to similar goods and services as a ‘breathtaking example of judicial lawmaking: despite the words of the provision being clearly (and admittedly) to the contrary’.²⁰⁰

6.4 Articles 6 and 7 of Directive 2008/95: Restraining Trade Mark Rights

Articles 6 and 7 of Directive 2008/95²⁰¹ are the other side of the coin to Article 5. Both articles lay down the limits of the powers of a trade mark proprietor. Article 6 sets out the circumstances in which the owner of the trade mark right may not prohibit third parties from using the trade mark, either because they are individual signs or for specific uses. For reasons of commercial policy, Article 7 prevents the trade mark owner from compartmentalising the intra-Community market by erecting barriers to the free movement of goods.²⁰²

¹⁹⁹ J McCarthy, ‘Dilution of a trade mark: European and United States law compared’ (2004) 94 *Trade Mark Report* 1178. Cornish and Llewelyn also seem to share the same view. They argue that: ‘the fact that he [the mark owner for similar goods who has a reputation] has that reputation does not exempt him from having to show the confusion element required under type 2 [likely confusion of association]; it simply aides his task’; W Cornish, D Llewelyn, *Intellectual Property: Patents, Copyrights, Trademarks and Allied Rights* (5th edn, Sweet & Maxwell, London 2003) 17- 101.

²⁰⁰ Cornish, Llewelyn (n 5) 721.

²⁰¹ Mirror Articles 12 and 13 of Regulation 207/2009 (n 105).

²⁰² Advocate General Opinion Ruiz-Jarabo Colomer in Case C-206/01 *Arsenal Football Club Plc v Matthew Reed* [2002] ETMR 82, AG 25, 26.

Article 6 reads:

1. The trade mark shall not entitle the proprietor to prohibit a third party from using, in the course of trade,
 - (a) his own name or address;
 - (b) indications concerning the kind, quality, quantity, intended purpose, value, geographical origin, the time of production of goods or of rendering of the service, or other characteristics of goods or services;
 - (c) the trade mark where it is necessary to indicate the intended purpose of a product or service, in particular as accessories or spare parts;provided he uses them in accordance with honest practices in industrial or commercial matters
2. The trade mark shall not entitle the proprietor to prohibit a third party from using, in the course of trade, an earlier right which only applies in a particular locality if that right is recognized by the laws of the Member State in question and within the limits of the territory in which it is recognized.

Article 6 of Directive 2008/95 seeks to reconcile the fundamental interests of trade mark protection with those of free movement of goods and freedom to provide services in the Common Market in such a way that trade mark rights are able to fulfil their essential role in the system of undistorted competition.²⁰³ Put differently, the aim of Article 6 is to set up a balance between the interests of the owner of the trade mark right in having a monopoly and those of his competitors.²⁰⁴

Similarly, Article 7 of Directive 89/104 (exhaustion of the rights conferred by a trade mark) shapes the limits of trade mark rights within the framework of the law.

It reads:

- ...The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.
2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialisation of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.

Article 7 prohibits the holder of a trade mark from relying upon the exclusiveness of the trade mark right to prohibit the marketing in a Member State of goods legally produced in another Member State. Permitting such an act would be inconsistent

²⁰³ *Adidas v Marca Mode* (n 175) para 45.

²⁰⁴ *Adam v Autec* (n 113).

with one of the essential objects of the Treaty: establishing the single market.²⁰⁵ In *BMW Nederland BV v Ronanl Karel Deenik*,²⁰⁶ the aim of Article 7 was thoroughly addressed. The European Court of Justice held that Article 7 seeks to:

...reconcile the fundamental interests of trade mark protection with those of free movement of goods and freedom to provide services in the common market in such a way that trade mark rights are able to fulfil their essential role in the system of undistorted competition which the Treaty seeks to establish and maintain.²⁰⁷

Article 7, therefore, is mainly intended to reconcile the rights of the owner of a registered trade mark with the essential goals of the law.²⁰⁸

Trade mark law provides general guidance as to trade mark functions and the interests that should be taken into account when protecting those functions. Hence, it is down to the Court of Justice to explain whether the quality function should be protected and, if so, in which context and why. This is addressed below.

7. Trade Mark Functions: A Quality Perspective

The final part of this chapter focuses on the enforcement of the quality guarantee under Article 5(1) and (2) of Directive 2008/95²⁰⁹ (corresponding to Article 9 (1) and (2) of Regulation 207/2009).²¹⁰ The goal is to identify fields of interests where the enforcement of the quality function raises cause for concern. Under Article 5, the protection of the quality function reveals two distinctive trends. The first is under Article 5(1). This tends to favour restriction of trade mark protection to its essential function, a badge of origin. Under this restricted approach, the enforcement of the quality function seems to be the most controversial in the field of trade marks exhaustion. The second trend tends to favour the expansion of trade mark protection under Article 5(2). The focus here is on expanding the scope and the level of trade mark protection regardless of the quality of the product to which the mark is

²⁰⁵ *CNL-Sucal v Hag* (n 166) paras 12- 13.

²⁰⁶ Case C-63/97 *Bayerische Motorenwerke AG (BMW) and BMW Nederland BV v. Deenik* [1999] ETMR 339.

²⁰⁷ *Ibid*, para 62. The court observed that the aim of Articles 6 and 7 are the same.

²⁰⁸ *Arsenal v Reed* (n 202).

²⁰⁹ Directive 2008/95 (n 104).

²¹⁰ Regulation 207/2009 (n 105).

attached. Next, we briefly explore the controversies surrounding the enforcement of the quality function in these two fields.

7.1 The Quality Function under Article 5(1) of Directive 2008/95

Under Article 5(1) of the Directive 2008/95, the protection of the trade mark is restricted to its essential function, a badge of origin.²¹¹ The roots of this approach are not difficult to trace back. In its Memorandum on the European Trade Mark Directive, the European Commission pointed out that:

Any regulation of trade mark law depends ultimately on the functions which are attributed to the trade mark. Both economically as legally the function of the trade mark as an indication of origin is paramount... From this basic function of the trade mark are derived all the other functions which the trade mark fulfils in economic life. If the trade mark guarantees that the commercial origin is the same, the consumer can count on a similarity of composition and quality of goods bearing the trade mark; and the advertising value of the trade mark requires that between the trade marked goods and the owner of the trade mark there is a definite legal relationship.²¹²

As to the interpretation of the quality guarantee and, while emphasizing the importance of the quality function for consumers, the Commission did not perceive this function as inherently worthy of protection. The Commission provided that:

Although the quality function predominates in the mind of the consumers and the publicity function predominates in the mind of the producers, so far as the legal aspect is concerned the decisive criterion is the function of the mark as an indication of origin. Only if the proper purpose of the trade mark is maintained, namely to distinguish the trade marked goods from goods of different origin, can it fulfil its further roles as an instrument of sales promotion and consumer information; and only then does the trade mark right perform its function of protecting the proprietor against injury to the reputation.²¹³

The Commission called for the restriction of trade mark protection to its essential function (a badge of origin). The Commission pointed out that:

²¹¹ See in general S Maniatis and A Sanders, 'A consumer trade mark: protection based on origin and quality' (1993) 15 EIPR 406- 415.

²¹² Memorandum on the Creation of an EEC Trade Mark (n 147) para 68.

²¹³ Ibid.

Only if protection is confined to the traditional and generally acknowledged function of the trade marks as an indication of origin, will the legal position be compatible with the principle of the free movement of goods.²¹⁴

However, under this origin-oriented form of protection, the interpretation of the quality function varies significantly. This variation can be clearly seen in the field of parallel importation where the enforcement of the quality guarantee differs depending on whether the act of violating the trade mark right has taken place inside the European Union or outside it.

7.2 Different Spheres, Different Interpretations: Trade Mark Exhaustion as an Example

The reason why the enforcement of the quality function inside the European Union is different from that outside the Union is that the Court of Justice implemented the principle of Community exhaustion.²¹⁵

Inside the European internal market, the quality function is secured via the origin one and rarely has any independent legal significance. This is despite the fact that the Court seems willing to adapt a broader view of the origin function which indicates not only the source of goods or services but also its quality.²¹⁶ In a number of limited cases, the quality function is seen as inherently worthy of protection because the protection of the mark does contribute to the objectives of the law by enabling traders and consumers to differentiate the products of one undertaking from those of other undertakings.²¹⁷ However, the enforcement of the quality function can *only* be initiated by the trade mark owner against parallel importers providing, among many things, that the condition of the goods is changed or impaired after they have been put on the market. This is despite the fact that the trade mark owner himself is not obliged to maintain the quality of his goods.

²¹⁴ Id.

²¹⁵ Case C- 355/96 *Silhouette International v Hartlauer Handelsgesellschaft* [1998] ECR I-4799; Case C- 173/98 *Sebago Inc and Ancienne Maison Dubois v GB-Unic SA* [1999] ECR I-4103.

²¹⁶ See in general Case C- 59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40; *CNL-Sucal v Hag* (n 166).

²¹⁷ Joined Cases C- 427, 429 & 436/93 *Bristol-Myers Squibb and Others v Paranova* [1997] 1 CMLR 1151.

By stark contrast, the quality function of the mark might be invoked against parallel importers even where the use of the mark does not affect its essential function.²¹⁸ A trade mark proprietor can repel the importation of cheaper goods from outside the Community even where the quality of those goods is identical to those sold inside the EU. Such a policy raises many serious questions about the impact of trade mark protection on the principle of free movement of goods hence competition. In the next chapter, all these issues will be thoroughly addressed.

7.3 The Quality Function under Article 5(2) of Directive 2008/95

A second interesting trend in relation to the interpretation of the quality function is identified under Article 5(2) of Directive 2008/95. This Article permits Member States to extend the protection afforded to marks with a reputation. Noticeably, even under this extended level of protection, the quality function seems to take a back seat. The law seems to be mainly focused on the protection of the investment made by a trade mark proprietor rather than on the protection of the interests of all related parties including consumers. Hence, unless the protection of the quality function directly affects the rights of the mark owner, the question of quality is not invoked. Put differently, consumers' expectations as to quality issues seem to be ignored under Article 5(2).

In *Copad v Christian Dior*,²¹⁹ the ECJ went quite far to protect the reputation of a trade mark as an indication of quality. The ECJ found that the quality of luxury goods results not just from their physical characteristics but also from their allure and prestigious image, which confer on them an aura of luxury.²²⁰ This expansion to the protection of marks with a reputation however might not be consistent with the broader policy of the law. This is because, as we have already established, protecting the quality of goods derived from their prestigious image rather than from their

²¹⁸ Case C- 355/96 *Silhouette International Schmied GmbH & Co. KG v Hartlauer Handelsgesellschaft mbH* [1998] 2 CMLR 953.

²¹⁹ *Copad v Christian Dior* (n 215) paras 24- 26.

²²⁰ *Ibid.*

physical characteristics does not enhance competition.²²¹ On the contrary, it could increase artificial product differentiation and artificial partitioning of markets. This raises a question as to the extent to which the expansion of the protection of a mark with a reputation enhances competition and reduces consumer searching costs. These issues will be the topic of the third chapter.

8. Overview

This chapter shows that the enforcement of the quality guarantee is important if trade mark protection is to promote competition and to reduce consumer searching costs.²²² As noted briefly before,²²³ the enforcement of the quality function seems to be particularly controversial in the field of exhaustion and in the case of protecting the intangible aspects of marks with a reputation. These two areas will be dealt with respectively.

Accordingly, the next chapter examines the enforcement of the quality function in the case of parallel trade. Under this field, the Court of Justice established the doctrine of a trade mark subject-matter which calls for restricting the protection of the trade mark to its essential function, a badge of origin.²²⁴ This doctrine has profoundly influenced the development of the quality function under trade mark law. To this we shall now turn our attention.

²²¹ See pages, 23, 31.

²²² Pages, 20- 22, 23, 31.

²²³ Page, 47.

²²⁴ Case 16/74 *Centrafarm BV v. Winthrop BV* [1974] ECR 1183.

CHAPTER TWO: THE QUALITY FUNCTION UNDER THE DOCTRINE OF THE TRADE MARK SUBJECT-MATTER

1. Introduction

The first chapter has focused on the importance of recognising and thus enforcing the quality guarantee if trade mark protection is to promote competition and reduce consumer searching costs. This chapter is concerned with the factors which impact the recognition and thus enforcement of the quality function under Article 5(1), in particular the doctrine of trade mark subject-matter. After analysing the historic development of this principle, this chapter, first demonstrates that the quality guarantee is not properly recognised under Article 5(1). Secondly, the chapter argues that the interpretation of the quality function under the trade mark subject-matter doctrine does not fit *easily* with the essence of restricting the protection of the mark to its essential function. This lack of harmony seems to favour traders at the expense of consumers.

There is an unending tension between the protection of trade mark rights and the principle of free movement of goods under the Treaty on the Functioning of the European Union (TFEU).¹ In order to prevent the use of these rights to artificially partition markets and to maintain price in the Union, the Court of Justice has established the doctrine of the trade mark subject-matter. Under this doctrine, the Court has restricted the protection of the mark to its core function, a badge of origin. Accordingly, rights that constitute the trade mark subject-matter are protected even if such a protection restricts free movement of goods and thereby distorts competition. However, rights that do not fall within the boundaries of the trade mark subject-matter are not protected. Examples include the quality guarantee which does not fall within

¹ For general information see H MacQueen, C Waelde, and G Laurie, *Contemporary Intellectual Property: Law and Policy* (OUP, Oxford 2008) 801; S Maniatis, D Botis, *Trade marks in Europe: a practical jurisprudence* (2nd edn, Sweet & Maxwell, London 2010) 622- 628; W Cornish and D Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights* (6th edn, Sweet and Maxwell, London 2007) 779- 796; C Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law* (Hart Publishing, Oregon 2007) 1- 25, 331- 366; R Peritz, 'Competition Policy and its Implications for Intellectual Property Rights in the United States' (2007) in S Anderman, (ed.) *The Interface between Intellectual Property Rights and Competition Policy* (CUP, Cambridge 2007) 160- 170.

the boundaries of that doctrine. As a result, consumers' expectations as to quality issues are not protected under trade mark law.²

The idea of protecting the essential function of a trade mark to enable the owner of the trade mark right to have full control over the quality of his goods is consistent with the economic rationales for trade mark protection. As noted before, providing the trade mark proprietor with an exclusive right over the use of his mark is important if the quality guarantee is to be ensured.³ The problem, however, is the lack of legal obligations upon the owner to exercise that quality control. This has contributed to the creation of a climate of legal uncertainty. The very absence of remedies, liabilities and enforceability of quality issues under trade mark law is apt to feed legitimate doubts over the very existence of the concept of trade mark protection as it is pictured, i.e. as a way of promoting competition and thus the production of quality products. The pros and cons of enforcing the quality function depend, to a great extent, on the context of its use. For example, opposing the importation of sub-standard goods from outside the Union might be easy to defend. However, keeping the essence of restricting the protection of the mark to its core function, opposing the importation of genuine branded goods from outside the Union seems very hard to justify. It is with this background that we turn to the topics of this chapter. What ought to be the proper scope of the trade mark subject-matter? Should the quality guarantee be included within the boundaries of that doctrine? Could the lack of quality enforcement contribute to the artificial partitioning of markets between Member States and to price maintenance?

This chapter begins by investigating the rationales for establishing the trade mark subject-matter doctrine and the impact of this policy on the implementation of the quality function. It then goes on to highlight the importance of the quality guarantee in the analysis of the trade mark subject-matter. This is done in part one and two. The third and fourth parts investigate the enforcement of the quality guarantee under both the European and international dimension. It will be argued that the Court of Justice has failed to put the essential function of the mark into its wider legal and economic contexts. The Court has carefully crafted the principle of the essential

² Case 16/74 *Centrafarm v. Winthrop* [1974] 2 CMLR, para 21.

³ Chapter one, 14.

function of the mark to ensure that, despite its protection, trade mark rights are not used to distort competition. By not enforcing the quality guarantee however, the former goal cannot be secured unless the traders of branded goods maintain a consistent quality. As discussed in chapter one, quality inconsistency increases searching costs and damages competition *pre se* and regardless of whether the failure to maintain quality is due to the trade mark owner's fault or to a third party.⁴ In either case, trade mark protection enhances artificial partitioning of markets and price maintenance, and hence distorts competition. Ultimately, it will be argued that it is an oversimplification to limit our analysis under the doctrine of the trade mark subject-matter to the essential function of the mark, a badge of origin. Instead, the author proposes that we recognize the independent nature of the guarantee function. Thus, the Court of Justice should explicitly recognise the quality function of the trade mark when shaping the scope of trade mark protection.

The disagreement concerning the enforcement of the quality guarantee becomes even more evident in the field of international exhaustion. In the course of establishing the trade mark's essential function, the ECJ held that trade mark protection enhances artificial partition of markets and price maintenance if it does not contribute to the establishment of the trade mark core function, a badge of origin.⁵ However, considering the ECJ ruling in *Silhouette*,⁶ it seems permissible to allow the owner of a trade mark right to prevent the importation of genuine goods from outside the Union even where the essential function of the mark is not impaired.

This chapter examines the *protection* of the quality guarantee in relation to parallel trade inside and outside the Union. The focus however is *not* on the exhaustion of trade mark rights. Rather, the aim is to provide examples where the interpretation of the quality function might raise cause for concern. While leading cases involving the question of trade mark exhaustion will be investigated, only issues that are directly related to the quality guarantee will be addressed.

⁴ Ibid, 28- 33.

⁵ Joined Cases C- 427, 429 & 436/93 *Bristol-Myers Squibb and Others v Paranova* [1996] ETMR 1, para 49.

⁶ Case C- 355/96 *Silhouette International Schmied GmbH & Co. KG v Hartlauer Handelsgesellschaft mbH* [1998] 2 CMLR, 953.

1.1 The Principle of Free Movement of Goods

The Treaty on the Functioning of the European Union (TFEU) provides provisions for both the free movement of goods and the protection of trade marks.⁷ Article 34 (ex Article 28) of the Treaty lays down the grounds for the principle of free movement of goods by prohibiting restriction on imports between Member States. It reads: ‘[q]uantitative restrictions on imports and all measures having the equivalent effect shall be prohibited between Member States’.

In *Société d'Importation v Publicité*, Advocate General Jacobs explained the guiding principle of that article.

The question then is what test should be applied in order to determine whether a measure falls within the scope of Article [34]. There is one guiding principle which seems to provide an appropriate test: that principle is that all undertakings which engage in a legitimate economic activity in a Member State should have unfettered access to the whole of the Community market, unless there is a valid reason for denying them full access to a part of that market.⁸

However, Article 36 (ex Article 30) of the TFEU grants some exceptions to Article 34 where the derogation of the free movement of goods principle can be justified providing that such a restriction does not constitute a mean of arbitrary discrimination or a disguised restriction on trade between Member States. Article 36 reads:

The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions *shall not, however, constitute a means of arbitrary discrimination or a disguised restriction* on trade between Member States. (Emphasis added)

Article 36 admits derogations from the free movement of goods only to the extent to which they are justified for the purpose of safeguarding rights which constitute the

⁷ See Articles 34, 36 and 345 (ex Articles 28, 30 and 295) of the Consolidated Version of the Treaty on the Functioning of the European Union [2008] OJ C 115/47; hereinafter referred to as the Treaty or the TFEN.

⁸ Advocate General Opinion Jacobs in Case C- 412/93 *Société d'Importation Edouard Leclerc- Siplec v TFI Publicité SA* [1995] ECR I- 179, AG 41.

core function of the rights.⁹ The second sentence of Article 36 also imposes a proportionality requirement where the Member seeking to justify a discriminatory measure must not only show that such discrimination does not represent arbitrary discrimination and does not unduly restrict trade in the Union but also must show that such a discriminatory measure is the least restrictive way of attaining this goal.¹⁰ Article 36 is the exception to the fundamental rule enshrined in Art.34 that goods should be able to move freely between Member States. Art. 36 is to be strictly construed as derogation from that basic rule (free movement of goods).¹¹

On the other side of the spectrum, Article 345 (ex Article 295) of the Treaty provides that ‘this Treaty shall in no way prejudice the rules of Member States governing the system of property ownership’. Hence, in the absence of Community harmonization measures, Article 345 provides Members with exclusive competence over intellectual property protection.¹² The ECJ upheld this fact. However, in *Commission v. United Kingdom*, the ECJ made it clear that when read with Articles 34 and 36, Article 345:

...cannot be interpreted as reserving to the national legislature, in relation to industrial and commercial property, the power to adopt measures which would adversely affect the principle of free movement of goods within the common market as provided for and regulated by the Treaty.¹³

To further explain the tension between trade mark protection and the principle of free movement of goods, we must examine the territorial nature of trade mark rights and to this we now turn.

1.2 The Tension between Trade Mark Protection and Free Movement of Goods

Balancing the goals of trade mark protection and free movement of goods is easier said than done. As explained before,¹⁴ Article 5(1) of Directive 2008/95¹⁵ (the

⁹ Advocate General Opinion Sharpston in Case C- 348/04 *Boehringer Ingelheim KG and Another v Swingward Ltd* [2007] 2 CMLR 52, AG 6; see also Case 78/70 *Deutsche Grammophon Gesellschaft mbH. v Metro-SB-Grossmärkte GmbH & Co. K.G.* [1971] CMLR 631, para 11.

¹⁰ *Deutsche v Metro* (n 9).

¹¹ Advocate General Opinion *Boehringer Ingelheim KG and Another v Swingward Ltd.* (n 9) AG 5; see also Case 113/80 *Commission v Ireland* [1982] 1 CMLR 706, para 7.

¹² For more information about this issue see S Maniatis, ‘Trade Mark Rights- a Justification Based on Property’ (2002) 2 IPQ 123.

¹³ Case C- 30/90 *Commission v. United Kingdom* [1992] ECR I- 829, para 18.

¹⁴ Chapter one, 41- 44.

Directive) and Article 9 (1) (a) and (b) of Regulation 207/2009¹⁶ confer on the proprietor exclusive rights which entitle him to prevent all third parties not having his consent from using his mark in certain cases. If left completely unrestricted, the owner of a trade mark could, for instance, use his right under Article 5 to prohibit the sale of goods put on the market by him or with his consent from being marketed under the trade mark in another Member State. This would negate the principle of free movement of goods guaranteed by Art. 34 (ex Article 28) and would be contrary both to the Treaty and to the stated objective of the Directive.¹⁷ That is why Article 7(1) of the Directive provides that the trade mark owner's right to prevent use of the mark 'shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent'. This is known as the doctrine of Community exhaustion. In this context, Articles 5 (1) and 7(1) counterbalance each other.¹⁸ Hence, once the conditions of Article 7(1) have been established, the protection of the mark is deemed to have been exhausted and the owner cannot use his exclusive right to oppose any further resale of goods sold under his mark in the Union. That is:

The proprietary rights have been used up. The owner of them has nothing left to deploy against further exploitation of the goods. This principle applies not only to patents and copyright, but to trade marks as well. So, once the rights holder has put protected products on the market or has consented to such marketing, he loses all rights to object to further exploitation. This effect is indefensible. The rights owner cannot override it by contract. The Member States cannot override it by national legislation.¹⁹

However, pursuant to Article 7 (2) of the Directive, the principle of Community exhaustion does not apply where 'there exist legitimate reasons for the proprietor to oppose further commercialisation of the goods. Considering the interpretation of the Court of Justice to Article 7 (2), it is implicit that the defence of exhaustion is intended to apply where the essential function of the mark, a badge of origin, is

¹⁵ Directive 2008/95 to approximate the laws of the Member States relating to trade marks [2008] L 299/25.

¹⁶ Regulation 207/2009 on the Community trade mark [2009] OJ L 78/1.

¹⁷ Directive 2008/95 provides that the Directive is intended to eliminate disparities between the trade mark laws of the Member States which may impede the free movement of goods and the freedom to provide services and distort competition within the common market.

¹⁸ Opinion of Advocate General (n 9) AG 11.

¹⁹ Case C- 414/99 *Zino Davidoff SA v A&G Imports Ltd* [2001] ETMR 67, para 32- 33.

affected.²⁰ And it is here that the interpretation of the specific subject-matter of trade mark rights or the core function of the right becomes significant. If the scope of the trade mark subject-matter is extended beyond the need to enforce the essential function of the mark, the monopoly power of the mark will also expand accordingly and, in this case, excessive protection may distort competition. At the same time, if the mark is not sufficiently protected, this would also damage competition by discouraging traders to invest on the quality of their branded goods which, in turn, minimises the economic efficiency of the market.²¹ Thus, it is a question of balance. In the next part, we examine the manner in which the Court of Justice reconciled these conflicting interests.

1.3 Establishing the Subject-matter of Protection

The Court of Justice repeatedly considered the fundamental question as to the point at which the principles of free movements of goods and freedom of competition are to be reconciled with the legal protection afforded to trade mark rights. As an interpreter of the TFEU, the Court has been trying the balance the granted rights of a trade mark owner under Articles 36 and 345 (ex Articles 30- 295) and the restrictions provided by Article 34 (ex Article 28). To this end, the Court considered the conditions against which Article 36 permits the proprietor of a registered trade mark to exercise his rights. To strike the correct balance, the Court of Justice established the doctrine of the trade mark subject-matter under which the protection of the mark is restricted to its core function.

At a very early stage, the Court of Justice recognised the importance of getting the balance right. In *Parke v. Probel* the ECJ held:

...the national character of the protection of industrial property and the variations between the different legislative systems on this subject are capable of creating obstacles both to the free movement... and to competition within the common market.²²

To ease the tension, the ECJ pointed out that harmonization of intellectual property regimes in the Community can be the answer. At the time *Parke Davis* was settled

²⁰ C Stothers, 'Who needs intellectual property? Competition law and restrictions on parallel trade within the European Economic' (2005) EIPR 1- 7.

²¹ Chapter one, 14.

²² Case 24/67 *Parke Davis &Co. v. Probel* [1968] CMLR 47, para 2.

however, there was no harmonization process.²³ That is why the Court of Justice developed a judicial solution by distinguishing between the existence of a right, which is protected under Article 345 of the TFEU, and the exercise of that right. After heavy criticism, the Court developed the principle of the essential function of the mark and to this we shall turn our attention.

1.4 The Essential Function of the Mark: The Early Days

In this part we examine the interpretation of the essential function of the mark within the boundaries of the trade mark subject-matter doctrine.

1.4.1 *Centrafarm*

The European Court of Justice first considered the question of trade mark exhaustion and the essence of the trade mark subject-matter in the Community in *Centrafarm v. Winthrop*.²⁴ The facts in this case were as follows. The American parent of the Sterling Winthrop group owned a patent for a urinary infection drug in the UK and the Netherlands. Sterling Winthrop held parallel patents for the drug, ‘Negram’, in the UK and Winthrop BV held the right in Holland. The price of this drug was higher in Holland than in the UK. Centrafarm purchased the patented drug in the UK and imported them into Holland without the permission of Sterling. Centrafarm was met by proceedings for infringement of the Dutch patent and trade mark. In respect of the case concerning the trade mark, the ECJ pointed out that under Articles 34 and 36 (ex Articles 28 and 30) the specific subject-matter of a trade mark guarantees:

...that the owner of the trade mark has the exclusive right to use that trade mark, for the purpose of putting products protected by the trade mark into circulation for the first time, therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade mark by selling products illegally bearing that mark.²⁵

Still, in order to eliminate any risk of using trade mark rights to establish artificial divisions within the Common Market, the ECJ went on to clarify that the concept of specific subject-matter does not grant the proprietor the right to prohibit the

²³ C Seville, *EU Intellectual Property Law and Policy* (Edward Elgar, Cheltenham 2009) 321.

²⁴ *Centrafarm v. Winthrop* (n 2) para 8.

²⁵ *Ibid.*

importation of a product which has already been put on the market by him or with his consent.²⁶ The ECJ concluded that:

... the exercise, by the owner of a trade mark, of the right which he enjoys under the legislation of a Member State to prohibit the sale, in that state, of a product which has been marketed under the trade mark in another Member State by the trade-mark owner or with his consent is incompatible with the rules of the EEC Treaty concerning the free movement of goods within the Common Market.²⁷

In *Hag* No 1(later on overruled by *Hag II*), the ECJ added that Article 36 of the Treaty permits derogations from the fundamental principle of free movement of good *only* to the extent necessary to safeguarding the specific subject-matter of industrial and commercial property.²⁸ The ECJ held that, unlike other industrial and commercial property, the exercise of trade mark right affects the free movement of goods between Member States and, in addition, it is not limited by time. In view of that,

...one cannot allow the holder of a trade mark to rely upon the exclusiveness of a trade mark right—which may be the consequence of the territorial limitation of national legislation—with a view to prohibiting the marketing in a Member State of goods legally produced in another Member State under an identical trade mark having the same origin.²⁹

Such an exclusive right, the right to prevent the resale of goods, jeopardises one of the essential objectives of the Treaty, namely free movement of goods. Within the boundaries of the single market, information as to the source of goods can be obtained via more friendly ways where the impact on the free movement of goods can be minimized.³⁰

1.4.2 *Hoffmann -La Roche*: Developing the Essential Function Principle

Hoffmann -La Roche is considered the formal birth of the principle of the essential function of a trade mark.³¹ In this case the ECJ developed the specific subject-matter of the trade mark including its envisaged essential function. The facts in that case

²⁶ Ibid, 10.

²⁷ Case 15/74 *Centrafarm BV and Another v Sterling Drug Inc.* [1974] 2 CMLR 480, para 12.

²⁸ Case 192/73 *Van Zuylen v. Hag* [1974] ECR 731, para 1.

²⁹ Ibid, 2.

³⁰ Ibid, 14.

³¹ Case 102/77 *Hoffmann- La Roche and Co AG v. Centrafarm vertriebsgesellschaft Pharmazeutischer Erzeugnisse mb H* [1978] ECR 1139.

were as follow. A product, “Valium”, was marketed in Germany by Hoffmann-La Roche for individual buyers in packages of 20 or 50 tablets and for hospitals in batches of five packages containing 100 or 250 tablets. The British subsidiary manufactures the same product in packages of 100 or 500 tablets at considerably lower prices than those obtaining in Germany. Centrafarm imported Valium purchased in Great Britain in the original packages which it put up into new packages of 1000 tablets and marketed in Germany. Centrafarm affixed the trade-mark of Hoffmann-La Roche together with a notice that the product had been marketed by Centrafarm. Centrafarm also gave notice of its intention to repack the tablets into smaller packages intended for sale to individuals. The ECJ was asked whether it is considered an infringement of the mark to deal in marked goods which have been repacked, re-marked or otherwise interfered with since the mark no longer indicates that the goods are under the control of a single undertaking.

The ECJ first emphasised that trade mark protection shall not restrict trade between Member States.³² Then the ECJ held that after having regard to Articles 34 and 36 of the Treaty, the specific subject-matter, in relation to trade marks aims in particular, to:

...guarantee the identity of the origin of the trade-marked product to the consumer or ultimate user, by enabling him without any possibility of confusion to distinguish that product from products which have another origin. This guarantee of origin means that the consumer or ultimate user can be certain that a trade-marked product which is sold to him has not been subject at a previous stage of marketing to interference by a third person, without the authorization of the proprietor of the trade-mark, such as to affect the original condition of the product.³³

According to the ECJ’s ruling, the essential function of the mark is to identify to the consumer or the end user the origin of goods. This provides the consumer with an assurance that the original condition of the products have not been impaired. In another case, when establishing the trade mark’s essential function, the European Court of Justice emphasised the need to take the precise scope of the right granted to the trade mark owner under that function.³⁴

³² Ibid, 6- 7.

³³ Ibid, 7.

³⁴ Case 3/78 *Centrafarm BV v. American Home Products* [1979] 1 CMLR 326, para 12- 14.

Hoffmann- La Roche and *Centrafarm* (discussed above) present a restricted interpretation to the scope of the trade mark subject-matter and thereby its essential function. The essence of this restricted approach is to limit the impact of trade mark protection in distorting trade between Member States. Under this approach, it is thought that Article 345 and the exceptions of Article 36 are reasonably balanced against Article 34. For this reason, the ECJ seems reluctant to expand the scope of legal protection to any right that is not part of the trade mark subject-matter.³⁵

Considering the significance of providing consistent quality if trade mark protection is to promote competition and reduce consumer searching costs,³⁶ it is important to investigate the legal status of the quality function within the boundaries of the essential function of the mark and to this we shall now turn.

1.5 Why not Enforce the Quality Guarantee under the Trade Mark Subject-matter Doctrine?

The doctrine of a trade mark subject-matter deals with the interests of consumers not being confused as to the source of goods and services through the enforcement of the essential function of a trade mark, a badge of origin. By identifying the source of goods or services, the mark is thought to serve a cluster of economic purposes including but not limited to, a guarantee of quality by preventing confusion in the mind of consumers.³⁷ Thus, protecting the essential function of the mark is a way of assuring consumers that branded goods are produced under the same source and, therefore, maintain the same level of quality.³⁸ In this context, the protection of the essential function can be regarded as a ‘precondition of investment’ in the mark.³⁹

When shaping the scope of the trade mark subject-matter, the Court of Justice did not protect the quality guarantee. The Court distinguished between the origin and the quality functions yet without an adequate explanation as to why it came to that conclusion and how the interests of consumers as to quality issues can be protected

³⁵ Seville (n 23) 322.

³⁶ Chapter one, 28.

³⁷ See in general Maniatis and Botis (n 1) 622- 643.

³⁸ Cornish and Llewelyn (n 1) 621.

³⁹ M Senftleben, ‘The Trademark Tower of Babel- Dilution Concepts in international, US and EC Trademark Law’ (2009) 40 IIC 46.

under the essential function doctrine. What is clear however is that consumers' expectations as to the quality function of the mark are not protected under trade mark law. Expectations in matters of quality pertain to the law of competition and criminal law, in the case of the branded goods causing damage to the health of the public.⁴⁰ Accordingly, raising the expectations of consumers as to a specific and constant quality in the product might not be considered as an essential element of the trade mark right and, therefore, cannot be protected under trade mark law.⁴¹ According to Beier, the quality guarantee is no more than an economic function that trade mark law should not bother itself with.⁴² Beier distinguishes between the positive role of a trade mark, such as its essential function, a badge of origin, and its negative role, for instance, the rights that it gives to its proprietor to restrain the activities of other traders encompassed in the specific subject matter within the orthodoxy of trade mark law. However, he identifies one exception where the definition of the essential function might be expanded, namely in the case of preventing dilution. This is because such a legal act does not require confusion as to the origin of goods and therefore falls outside the boundaries of the essential function.⁴³ Hence, apart from the protection of the mark with a reputation, it is perfectly conceivable that the right of the owner of a registered mark is restricted to the protection of the essential function of the mark, a badge of origin.

Beier's article has a profound legal impact on the enforcement of the quality function under trade mark law. In *Cinzano v Java*, the Federal Court of Justice of Germany (the Bundesgerichtshof) held that a 'trade mark does not have any guarantee function in the legal sense, that is, it does not compulsorily guarantee consistent quality of the marked goods'.⁴⁴ In *Terrapin v Terranova*, the Advocate General Mayras drew heavily on Beier's article (discussed above) when he explained the specific subject-matter of a mark. According to Mayras, the function of the mark is not a 'guarantee, for it does not necessarily guarantee consistency of quality of the product so marked'.

⁴⁰ F Beier, 'Territoriality of Trademark Law and International Trade' (1970) 1 IIC 48. Beier contributed to the original proposal of the European Trade Mark Directive as an adviser to the Commission.

⁴¹ Ibid, 21.

⁴² Ibid, 63.

⁴³ Beier (n 40) 64.

⁴⁴ Case I ZR 85/71 *Francesco Cinzano & Cie GmbH v Java Kaffeegeschäfte GmbH & Co.* [1974] 2 CMLR 21, para 11.

Rather, its function is to indicate the origin of the product.⁴⁵ Hence, the exclusive right of use given by the legislature to the proprietor of the trade mark protects him only vis-à-vis confusing use of it for other products. In addition to the trade mark subject-matter, namely the origin function, the mark has the so-called ‘incidental functions’. In that sense, it suggests a quality or a reputation. The Advocate General held, citing Professor Beier, that these qualitative and publicity functions are not legally protected under trade mark law. Rather, they should be protected under contract law, competition law and tortious liability.⁴⁶ Hence, the owner of the trade mark right can prevent a competitor from using an identical or similar trade mark for identical or similar products to create a risk of confusion as to the origin of the product. This protection is also important to protect the public against confusion.⁴⁷

In *Hoffmann- La Roche*, when an argument concerns an alleged connection between the prohibition of the repackaging of pharmaceutical products and the requirement of safeguarding consumers and protecting public health, the Advocate General also made it clear that such a connection does not exist under trade mark law and therefore it cannot be used to show that that prohibition stems from the specific function of the trade mark.⁴⁸ The Advocate General then made a reference to the ECJ ruling in *Centrafarm v. Winthrop*⁴⁹ where the ECJ held that the ‘specific considerations underlying the protection of industrial and commercial property are distinct from the considerations underlying the protection of the public and any responsibilities which that may imply’.⁵⁰

In *Hoffmann- La Roche*, the Advocate General recognised the role of a trade mark in arousing the expectations of consumers as to a specific and constant quality in the product. However, he made it clear that the quality function cannot be considered as an essential element in the trade mark right.⁵¹ Reiterating Professor Beier’s argument,

⁴⁵ 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.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*, 490, 491.

⁴⁸ 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.

⁴⁹ *Centrafarm v. Winthrop* (n 2).

⁵⁰ *Ibid.*, 22.

⁵¹ Opinion of Advocate General (n 48).

the Advocate General pointed out that the quality guarantee of the mark is not covered by the protection afforded by the trade mark right. Protection against fraud in matters of quality pertains to the law on ‘unfair competition and to the criminal law’.⁵²

2. Relationship between the Quality and Origin Function: A Modern Interpretation

On a few occasions, the Court of Justice addressed the interplay between the origin and quality function. Next, we highlight two leading examples.

2.1 HAG II

In *HAG II*, the ECJ interpreted the guarantee of origin as an assurance on consistent quality.⁵³ In this case, the ECJ explained the interaction between the quality and origin function. As such, it involved the ECJ balancing the interests of consumers and traders as to quality issues within the boundaries of the specific subject-matter doctrine. The facts in this case were as follows: H was a German manufacturer of decaffeinated coffee established in 1906. It registered the trade mark ‘Kaffee Hag’ in Belgium in 1908. In 1927, H set up a wholly owned and controlled subsidiary in Belgium and registered the trade mark ‘Cafe Hag’ in Belgium. In 1944 the subsidiary was sequestrated and later became the trading company S, retaining the trade mark. In 1985, S began to supply decaffeinated coffee to Germany under the ‘Hag’ trade mark. H sought to impose restrictions on S alleging that S was importing coffee which bore an identical or confusingly similar trade mark to H’s goods. The German Federal Court of Justice sought a preliminary ruling as to whether H’s restrictions constituted a restraint of trade contrary to Articles 28 and 30 of the Treaty of Rome. In the course of establishing the trade mark subject-matter, and thus the essential function of the mark, the Advocate General succinctly summarised the interplay between the origin and quality function.⁵⁴

...the relevance of the trade mark’s function as a guarantee of origin lies none the less in the fact that the trade mark conveys to the consumer certain perceptions as to the quality of the marked goods. The consumer is not interested in the commercial origin of goods out of idle curiosity; his interest

⁵² Ibid.

⁵³ Case C- 10/89 *S.A CNL-SUCAL NV v HAG GF AG* [1990] 3 CMLR 571.

⁵⁴ Opinion of AG Francis Jacobs in Case C- 10/89 *S.A CNL-SUCAL NV v HAG GF AG* [1990] 3 CMLR 571, AG 604.

is based on the assumption that goods of the same origin will be of the same quality. That is how trade mark protection achieves its fundamental justification of rewarding the manufacturer who consistently produces high-quality goods.

In its judgment, the ECJ drew heavily on the settled case law.⁵⁵ It emphasised the role of marks in the system of undistorted competition. The ECJ stressed the importance of allowing traders ‘to gain consumers by the quality of their products or services’ and this can only be done by granting the proprietor an exclusive right to use the mark to distinguish articles.⁵⁶

By explaining the essence of the essential function of the mark, in particular the circumstances in which the owner of the trade mark right might exercise the rights conferred on him by law, the ECJ highlighted the importance of the quality function within the boundaries of the essential function doctrine. The ECJ held that the essence of the origin function is to enable the owner of the mark full control over the quality of the products for which he should be held accountable.⁵⁷

According to this interpretation, identifying the physical origin of the goods is not the goal. The essence of identifying and thus protecting the origin function is, *inter alia*, to assure consumers that goods of the same origin will be of the same quality. To this end, the owner is granted an exclusive right to use its mark. The protection of the essential function therefore (identifying the origin of a product) is no more than a vehicle to protect the interest of the trade mark owner, on the one hand, and to assure consumers about the quality of the product on the other.

The ECJ however did not go any further in clarifying the legal implication of that liability (liability concerning the quality of products) nor did it explain whether traders themselves should be bound by this quality liability or it is only a legal tool traders can use against others who try to impair the quality (conditions) of the original product. This is a very important point. As discussed before, trade mark protection does not reduce consumer reaching costs unless the owner of the trade mark right

⁵⁵ *CNL-SUCAL v HAG* (n 53) paras 13, 14, 16.

⁵⁶ *Ibid*, 13.

⁵⁷ *Ibid*, 16.

maintains consistent quality.⁵⁸

2.2 *IHT*

Very similar remarks concerning the interplay between the origin and quality guarantee were made in *IHT*.⁵⁹ In this case, the Ideal Standard mark was originally owned by the American Standard group, via its French and German subsidiaries, and used for sanitary ware and heating equipment. The French subsidiary was in financial trouble and sold the trade mark for heating equipment only to another French company, Compagnie Internationale du Chauffage, which had no legal or economic links with American Standard. The *IHT* then sought to import goods bearing the mark from France into Germany. The German subsidiary objected and brought proceedings for infringement. The European Court of Justice pointed out that the German subsidiary can prevent the goods bearing the trade mark from being imported into Germany. This is because the mark is a guarantee of quality. The ECJ held that the mark must offer a guarantee that all goods bearing it have been produced under the control of a single undertaking which is accountable for their quality.⁶⁰

However, when explaining the legal nature of that quality control within the boundaries of the essential function of the mark, the ECJ pointed out that the decisive factor is whether or not the trade mark owner has the possibility of control over goods to which the mark is attached. The ECJ observed:

...that the decisive factor is the possibility of control over the quality of goods, *not the actual exercise of that control*. Accordingly, a national law allowing the licensor to oppose importation of the licensee's products on grounds of poor quality would be precluded as contrary to Articles [34] and [36]: if the licensor tolerates the manufacture of poor quality products, despite having contractual means of preventing it, he must bear the responsibility. Similarly if the manufacture of products is decentralized within a group of companies and the subsidiaries in each of the Member States manufacture products whose quality is geared to the particularities of each national market, a national law which enabled one subsidiary of the group to oppose the marketing in the territory of that State of products manufactured by an affiliated.⁶¹ The lack of such assurance would mean that the proprietor of the trade marked products can not be held accountable for their quality.⁶² (Emphasis added)

⁵⁸ Chapter one, 28- 33.

⁵⁹ Case C- 9/93 *IHT Internationale Heiztechnik v Ideal-Standard* [1994] 3 CMLR 857.

⁶⁰ *Ibid*, 37.

⁶¹ *Ibid*, 38.

⁶² *Ibid*, 37.

Considering the importance of maintaining consistent quality if trade mark protection is to promote competition and to reduce consumer searching costs, the above citation should raise cause for concern. Achieving the above goals may not be always possible, in particular, where the owner of the mark has a symbolic rather than a true quality control. Taking the legal and economic rationales of protection, establishing the essential function of the mark does not achieve its objectives unless the owner maintains consistent quality. This is quite an important point. If the essence of allowing the owner of the trade mark to oppose further circulation of goods between Member States is simply to provide him with a symbolic, rather than an actual, control over the quality of his goods, the protection of the mark may constitute artificial partitioning of markets and thereby distort competition.⁶³ Further, as we have already discussed in *Hag II*, the essence of the essential function is, *inter alia*, to allow the owner of the trade mark control over the quality of his goods for which he should be held accountable.⁶⁴ With this in mind, the trade mark owner should be required to exercise actual quality control.

Next, we look at the enforcement of the quality guarantee under Directive 89/104. The purpose is to examine whether the interpretation of that function has changed and if so in which direction.

3. Quality Function Enforcement under Directive 2008/95: The EU Dimension

The Trade Mark Directive 2008/95 is intended to approximate the laws of Member States. That is why national trade mark laws have to be assessed in the light of its provisions. As secondary legislation, the Directive also has to be interpreted in the light of the Treaty thus the Court of Justice's case law becomes important.⁶⁵ The Court dealt with the question of trade mark rights and free movement of goods on many occasions in which the Court enforced the quality function under the Community exhaustion differently from that under international exhaustion. That is why we will deal with these two issues separately. We consider first the question of quality under the principle of Community exhaustion.

⁶³ Chapter one, 28- 33.

⁶⁴ See page, 65.

⁶⁵ *Bristol-Myers v Paranova* (n 5) paras 26, 27.

3.1 From *Bristol-Myers* to *Christian Dior*

The question of a trade mark subject-matter was first considered under Directive 89/104 (replaced by Directive 2008/95) in *Bristol-Myers Squibb* (BMS).⁶⁶ The ECJ first considered the interpretation of Article 7 of the Directive in circumstances where the trade mark proprietor was seeking to prevent an importer from marketing products which had been on the market in another Member State by that proprietor or with his consent but where the importer had repackaged the product and reaffixed the trade mark without the proprietor's authorisation.

The ECJ first addressed the interplay between Article 7 (1) and (2) of the Directive and Articles 28 and 30 of the Treaty of Rome (now Articles 34- 36). The ECJ held that Article 7(2) and Article 36 are mainly intended to reconcile the tension between the fundamental interest of protecting the trade mark rights and the objectives of the Directive and the Treaty.⁶⁷ After emphasising the role of trade marks in promoting competition and therefore the importance of protecting the essential function of the mark,⁶⁸ the ECJ held that trade mark rights are not intended to allow their owners to 'partition national markets and thus promote the retention of price differences which may exist between Member States'.⁶⁹ The goal of this exclusive right is not only to enable the trade mark owner to prevent others from using his mark but also to enable consumers to make informed purchasing choices on the basis of the assumption that goods sold under the same name will normally be of uniform quality. Thus:

Trade mark law seeks to protect the interests, *not only of the trade mark proprietor, but also of the consumer*. In so far as the trade mark protects the interests of its proprietor by enabling him to prevent competitors from taking unfair advantage of his commercial reputation, the exclusive rights conferred on the proprietor are said, in the language of the Court's case law, to constitute the specific subject-matter of the trade mark. In so far as the trade mark protects the interests of consumers by acting as a guarantee that all goods bearing the mark are of the same commercial origin, that is known, in the Court's terminology, as the essential function of the trade mark. Those two aspects of trade mark protection are of course two sides of the same coin.⁷⁰ (Emphasised added).

⁶⁶ Ibid.

⁶⁷ Ibid, 40.

⁶⁸ Ibid, 43.

⁶⁹ Ibid, 46.

⁷⁰ Joined Cases C- 427, 429 & 436/93 *Bristol-Myers Squibb and Others v Paranova* [1997] 1 CMLR 1151, para 72.

The European Court of Justice went on to say that the use of the trade mark right by the owner *will* contribute to the artificial partitioning of the markets between Member State where it is shown that ‘repackaging cannot adversely affect the original condition of the product’ or where the ‘owner of the mark receives prior notice before the repackaged product is put on sale’ and where it is stated on the new packaging by whom the product has been repackaged.⁷¹ The ECJ also held that opposing marketing of repackaged goods by a third part would contribute to the partitioning of markets between Member States in particular:

Where the owner has placed an identical pharmaceutical product on the market in several Member States in various forms of packaging, and the product may not, in the condition in which it has been marketed by the trade mark owner in one Member State, be imported and put on the market in another Member State by a parallel importer.⁷²

Hence, the use of the trade mark right by the owner will contribute to the artificial partitioning of the markets between Member States; provided, *inter alia*, that in the course of such repackaging, the guarantee of origin is not impaired and the original condition of the product is not adversely affected. In other words, the prevention of the resale of goods is considered artificial partitioning of the market if such a restriction cannot be justified by the need to safeguard the essential function of the mark, badge of origin.⁷³

In *Loendersloot v Ballantine*, the European Court of Justice reaffirmed its interpretation of the essential function of the mark.⁷⁴ In this case, the ECJ considered the removal of itemisation numbers which had various uses, including tracking goods in different Member States. The ECJ emphasised that trade mark rights *are not* intended to allow ‘their owners to partition national markets and thus assist the maintenance of price differences which may exist between Member States.’⁷⁵ Rather, these rights are intended to enable the mark to perform its essential function, a badge of origin.⁷⁶ In *Christian Dior v Evora*,⁷⁷ the ECJ came to the same conclusion.

⁷¹ *Bristol-Myers v Paranova* (n 5) para 49.

⁷² *Ibid*, 52.

⁷³ See in general L Bently, and B Sherman, *Intellectual Property Law* (3rd edn, OUP, Oxford 2009) 946.

⁷⁴ Case C- 349/95 *Loendersloot v Ballantine* [1998] 1 CMLR 1015.

⁷⁵ *Ibid*, 23.

⁷⁶ *Ibid*, 25.

⁷⁷ Case C- 337/95 *Christian Dior v Evora* [1998] 1 CMLR 737, para 37.

3.2 *Van Doren* Draws the Line: When Trade Mark Protection Contributes to Artificial Partitioning of Markets between Member States

Van Doren is an interesting case.⁷⁸ Despite the fact that it is not directly related to the question of quality, it provides a good example as to the Court's efforts to ensure that trade mark rights are not used to artificially partition the markets between Member States. In this case, the ECJ was required to give a preliminary ruling on the interpretation of Art.34 and Art.36 (ex Articles 28 and 30) of the TFEU and Art.7 (2) of Directive 2008/95 (former Directive 89/104). The dispute was on whether goods were placed on the market for the first time within or outside the Community, which raised the question of the burden of proving where the trade marked goods were first put on the market. Under German law, exhaustion of trade mark rights must be proved by the third party who relies on it.

The ECJ held that the requirements deriving from the protection of the free movement of goods enshrined in Arts 34 and 36 (ex Articles 28- 30) necessitate that the rule of evidence needs to be qualified.⁷⁹ This must be so, the ECJ added, where that rule (the rule of evidence as to whether trade mark rights have been exhausted) would allow the 'proprietor of the trade mark to partition national markets and thus assist the maintenance of price differences which may exist between Member States'.⁸⁰ The ECJ went on to provide examples where trade mark rights might artificially partition markets. This includes cases where the trade mark proprietor markets his products in the Community using an exclusive distribution system. In this case:

...if the third party were required to adduce evidence of the place where the goods were first put on the market by the trade mark proprietor or with his consent, the trade mark proprietor could obstruct the marketing of the goods purchased and prevent the third party from obtaining supplies in future from a member of the exclusive distribution network of the proprietor in the EEA, in the event that the third party was able to establish that he had obtained his supplies from that member. Accordingly, where a third party against whom proceedings have been brought succeeds in establishing that there is a real risk of partitioning of national markets if he himself bears the burden of proving that the goods were placed on the market in the EEA by the proprietor of the trade mark or with his consent, it is for the proprietor of the trade mark to establish that the products were initially placed on the market outside the EEA

⁷⁸ Case C- 244/00 *Van Doren + Q GmbH v Lifestyle Sports + Sportswear Handelsgesellschaft mbH* [2003] 2 CMLR 6.

⁷⁹ *Ibid*, 37.

⁸⁰ *Ibid*, 38.

by him or with his consent. If such evidence is adduced, it is for the third party to prove the consent of the trade mark proprietor to subsequent marketing of the products in the EEA.⁸¹

Thus, unless it is very difficult to do so, the burden of proof that trade mark rights have been exhausted falls on the defendant.

3.3 Where are we Now?

The quality guarantee is yet to be properly recognised within the boundaries of the trade mark's essential function principle. It has been argued that due to the way business activities are carried in today's market, it might not be possible to enforce the quality guarantee.⁸² In *Scandecor* (before the House of Lords), Lord Nicholls stated that consumers in general are fully aware that the management of the business concerning a particular mark might change regularly and, therefore, it would be irrational to assume quality control over goods through the registration mechanism. He stated:

This approach accords with business reality and customers' everyday expectations. Customers realise there is always the prospect that, unbeknown to them, the management of a business may change. To confine the use of a trade mark to the original owner of a business would be to give the concept of a business origin or business source an unrealistically narrow and impractical meaning. Of course, the new management, the new owners, may not adhere to the same standards as the original owner.⁸³

Lord Nicholls later added that what really guarantees the quality of goods is the economic interest of the proprietors of keeping the value of their goods rather than any legal duties to do so. He observed:

In relying on a trade mark consumers rely, not on any legal guarantee of quality, but on the proprietor of a trade mark having an economic interest in maintaining the value of his mark. It is normally contrary to a proprietor's self-interest to allow the quality of the goods sold under his banner to decline.⁸⁴

Lord Nicholls succinctly summarised the contemporary legal view towards the enforcement of the quality guarantee: the expectations of consumers as to the quality function are not enforced under trade mark law even if maintaining a consistent level

⁸¹ Ibid, 39- 41.

⁸² *Scandecor Development AB v Scandecor Marketing AB & Others*, [2001] 2 CMLR 30.

⁸³ Ibid, 22.

⁸⁴ Ibid, 19.

of quality might be a very important part of purchasing a branded good in the first place.

Most recently, the European Court of Justice has considered the essential function of a mark in *Copad v Christian Dior*.⁸⁵ The ECJ reiterated its position in previous cases. It repeated the same mantra that the essential function of the mark is to guarantee the identity of origin of marked goods or services and the mark must offer a guarantee that all the goods or services bearing it have been manufactured or supplied under the control of a single undertaking which is responsible for their quality.⁸⁶

In a nutshell, the essential function of the mark is to indicate the origin of goods to consumer or end user. But it does not have quality guarantee in the legal sense.

4. Quality Guarantee Enforcement: A Critical Review

A number of cases, most notably *Hoffman-La Roche* and *Centrafarm* are cited as a narrow interpretation of the doctrine of the trade mark subject-matter, a badge of origin. By contrast, *HAG II* and *IHT* are cited as a modern interpretation of the essential function of trade mark as something that goes beyond the guarantee of origin. In neither case however, the ECJ did go as far as to require traders to maintain consistent quality.

In the next part, we explain why it is important to pay regard to the quality function when establishing the trade mark essential function.

4.1 The Importance of the Quality Function in the Analysis of the Trade Mark Subject-Matter

The question concerning the need to enforce the quality guarantee relates to the justification of the establishment of the trade mark subject-matter in the first place and whether a tension arises between the justifications for the right and, therefore, the

⁸⁵ Case C- 59/08 *Copad SA v Christian Dior Couture SA and others* [2009] ETMR 40.

⁸⁶ *Ibid*, 22.

objectives of the law and the methods of protecting that right.⁸⁷ As we have already seen, the Court of Justice restricts trade mark protection to its core function in order to reduce the effects of the territorial nature of the trade mark right in restricting trade between Member States. In this case consumers are protected against confusion as to the source of goods. Under this scenario, it is thought that the interests of both traders and consumers are met. Nonetheless, an analysis of the trade mark function that contents itself with a reference *only* to the legal rationale of protection, inevitably, remains incomplete. It neglects the very purpose of branding in the first place: differentiating the product of one undertaking from those of other undertakings. To solve this problem, the economic rationale of trade mark protection must also be included. As explained in chapter one, the goal of trade mark protection is to encourage the traders of branded goods to maintain and improve the quality of their goods.⁸⁸ That is why the owner of a mark is given the right to put goods into circulation for the first time and thus to oppose infringement. In *S.A. Cnl-Sucal NV v Hag*,⁸⁹ the Advocate General pointed out that:

Like patents, trade marks find their justification in a harmonious dovetailing between public and private interests. Whereas patents reward the creativity of the inventor and thus stimulate scientific progress, trade marks reward the manufacturer who consistently produces high quality goods and they thus stimulate economic progress. Without trade mark protection there would be little incentive for manufacturers to develop new products or to maintain the quality of existing ones. Trade marks are able to achieve that effect because they act as a guarantee, to the consumer, that all goods bearing a particular mark have been produced by, or under the control of, the same manufacturer and are therefore likely to be of similar quality.

Hence, the essence of protecting the trade mark subject-matter is to promote competition and thus economic efficiency. As discussed in chapter one however, this goal can only be achieved where traders maintain consistent quality.⁹⁰

The enforcement of the quality guarantee is related to the issue of linking the subject-matter of protection (producing quality goods) and the goals of protection. It also relates to interests that should be taken into account when protecting trade mark

⁸⁷ As discussed in chapter one, the major aim of trade mark law is to promote competition and to reduce consumer searching costs.

⁸⁸ Chapter one, 14.

⁸⁹ Opinion of Advocate General (n 54) AG 583.

⁹⁰ Chapter one, 28.

functions. If trader interests are at the forefront of the debate, then traders should not be forced to maintain the quality of their goods. This is because it is believed that traders who are unable to maintain the quality of their good are likely to lose business.⁹¹ If on the other hand it is the interests of consumers within the Union that is of prime concern, then traders must maintain the quality of their branded goods otherwise trade mark protection increases rather than decreases consumer searching costs.⁹² As noted in the first chapter however, both interests are relevant under the Trade Mark Directive 2008/95 and the TFEU.⁹³

The doctrine of the trade mark subject-matter should be interpreted in a way that accommodates these two distinctive interests. This is because the interests of the trader and consumer under the trade mark subject-matter do not always coincide. For one reason or another, a trader might not be willing or able to maintain the quality of his branded goods. In such a case the interests of the trader and his targeted consumers collide. Thus, the question of the subject-matter eligible for protection concerns one of the basic notions of protection against confusion: what is in that should be protected under the origin function of the mark and in what context?

The preceding discussion should lead us to the following question: does the protection of the trade mark essential function contribute to the legal and economic rationales of protection *even* where the trade mark owner himself fails to maintain the quality of his goods? Considering the economic role of trade marks,⁹⁴ and taking the Court case-law into account, the enforcement of the origin function rests in the fact that the trade mark conveys to the consumer certain perceptions as to the quality of the branded goods.⁹⁵ Without this quality message, it would be difficult to justify why consumers would be interested in identifying the source of a product in the first place.

4.2 The Protection of the Trade Mark Subject-matter: A Simple Solution for a Very Complicated Problem

⁹¹ Ibid, 14.

⁹² Ibid, 28- 33.

⁹³ Ibid, 38.

⁹⁴ Ibid, 28- 33.

⁹⁵ See pages, 64- 66.

In the light of the previously discussed cases, the Court of Justice appeared to be saying that the proprietor of a trade mark right can use the guarantee of origin which implies consistent quality to stop the importation and resale of goods if the essential function of the mark is impaired.⁹⁶ This can happen where, for instance, the packaging of imported goods is of poor quality or untidy since such an act might affect the origin function of the mark or its reputation. If this is really what the Court intended, then it would appear that the act of not maintaining the quality of the branded goods set up by the trader will affect the essential function of the mark and inevitably competition. However, if the same act is committed by the owner of the trade mark right, then that might not have the same legal effect. This is because the trader is not legally required to maintain the quality of his branded goods.

In *Bristol-Myers* (discussed before),⁹⁷ the Advocate General pointed out that consumers will be disadvantaged by parallel imports which have been tampered with before being placed on the market, because they will assume that the goods have been produced under the control of the trade mark owner and so possess the quality normally associated with that trade mark and if they do not the origin function will be compromised.⁹⁸ However, as already noted, the ECJ came to the conclusion that responsibility for quality, although different from indication of origin, is not the same as the mark guaranteeing that the goods will be of a certain quality.⁹⁹

Once again, such a narrow interpretation fails to acknowledge the rationale behind establishing the trade mark subject-matter and, therefore, restricting the protection of the mark to its core function, a badge of origin. The essence of protecting the trade mark is to reward traders who produce high quality products and to encourage them to maintain that level of quality. In this context, the essential function of the mark is designed to enable the owner of the trade mark right to have full control over the quality of his goods for which he should be held accountable.¹⁰⁰ The use of trade mark rights to oppose further commercialization of goods should be tolerated *only* where such a restriction contributes to the economic progress of the market. This progress

⁹⁶ *Bristol-Myers v Paranova* (n 5) para 49.

⁹⁷ Page, 69.

⁹⁸ Opinion of Advocate General (n 70) AG 78.

⁹⁹ *Centrafarm v. Winthrop* (n 2).

¹⁰⁰ *CNL-SUCAL v HAG* (n 53) para 16; *IHT v Ideal-Standard* (n 59) para 37.

can only be secured where the mark conveys, among many other things, a true and genuine quality message.

Clearly, the precise legal status of the quality guarantee is difficult to pin down in the Court's case law. Nonetheless, the doctrine of the trade mark subject-matter should serve a distinct public interest, most notably consumer interests, which should be understood as distinguishable from those of the proprietor. To this end, more attention should be paid to the question of quality, which leads us to the next part of this discussion.

4.3 The Deficiencies of the Trade Mark Subject-matter Doctrine

Despite its surface appeal, on deeper scrutiny, the principle of restricting trade mark protection to its essential function suffers from internal inconsistency and practical difficulties. This lack of consistency is related to the failure of the Court of Justice to engage with the question of how exactly the quality function relates to the origin one or, more importantly, how it is related to the essence of trade mark protection. The analysis of the relationship between the subject-matter and the purpose of protection yields an interesting result. Easing the tension between trade mark protection and free movement of goods can only be effective where the traders of branded goods maintain consistent level of quality. Otherwise, as explained in chapter one, trade mark protection would enhance artificial product differentiation and increase searching costs.¹⁰¹ The failure to maintain consistent quality harms competition and the interests of consumers regardless of whether the act of not maintaining quality is committed by the trade mark owner or a third party (a parallel importer). It is not the trade mark rights granted under Article 5 of Directive 2008/95 and Article 345 of the TFEU which are questionable here. Rather, it is the fact that the protection of the trade mark right is based on a cluster of economic benefits that justify the existence of the right itself. Hence, these benefits must be secured if the mark is to stay a viable economic tool. One cannot be blamed for questioning the right of a trade mark owner to oppose parallel trade to protect the original conditions of the goods given the fact that the owner himself is not required by law to maintain the quality of his goods. Providing the trader of branded goods with such a right is inconsistent with the

¹⁰¹ Chapter one, 28-33.

essence of establishing the trade mark subject-matter under the law and the Treaty. This trend to overlook the significance of protecting quality issues under trade mark law underestimates the economic significance of this function and, possibly, prevents the achievement of the essential goals of the law. It is therefore necessary to give substance to the indeterminate legal status of the quality function and, in doing so, to keep the goals of the Directive and the rationales of identifying the trade mark subject-matter very much in mind. Ultimately, the position of the Court of Justice on the enforcement of the quality function of the mark reveals three major drawbacks.

First, the Court did not explain how the damage to competition caused by the failure of branded goods to maintain a consistent level of quality can be justified under trade mark law whether or not the reduction in quality raises health or safety concerns. In other words, this approach does not explain how the damage to competition process can be justified if the act of reducing quality is not caught under consumer or criminal law.

Second, as we explained before,¹⁰² trade mark protection is said to promote competition and to reduce consumer search costs. The failure to maintain a consistent quality increases consumer search costs.¹⁰³ This should not be tolerated under trade mark law given the fact that one of the main reasons for protecting marks is to reduce consumer searching costs.

Finally, the Court of Justice seems eager to minimize the monopoly power of the trade mark owner by restricting the protection of the mark to its core function. Yet by not adequately emphasising the link between the quality and origin function within the boundaries of the trade mark subject-matter, the Court weakens the effectiveness of its approach.

4.4 Should the Quality Function be Protected?

In the light of the above, this part asks the following question: should the quality guarantee be enforced? It will have been apparent from reading previous parts that

¹⁰² Ibid, 20- 22.

¹⁰³ Ibid, 28.

the essential function of a trade mark may indicate many things including origin as well as quality.¹⁰⁴ Thus, to state that the origin function should be the only protectable function under the trade mark subject-matter, the statement which was once described by Advocate General Ruiz-Jarabo Colomer of the European Court of Justice as ‘simplistic reductionism’,¹⁰⁵ may be to put the case too strongly. But it is certainly true that it is the essential function of trade mark to indicate the origin of goods or services unambiguously.

A much more sustainable approach can be reached which provides that trade marks perform much wider functions than the badge of origin. Accordingly, the quality guarantee is also worthy of protection. A trade mark makes:

... a statement about quality, reputation and even, in certain cases, a way of seeing life. In this context, a distinctive sign can indicate... the quality of the goods it represents...I see no reason whatever not to protect those other functions of the trade mark and to safeguard only the function of indicating the trade origin of the goods and services.¹⁰⁶

To conclude, the Court of Justice should pay more regard to the essence of establishing the trade mark subject-matter, namely enhancing competition. To this end, the Court may revisit its position regarding the enforcement of the quality function under the trade mark essential function doctrine. The quality function should play a role when shaping the scope and the form of trade mark protection.

5. The Enforcement of the Quality Function: The International Dimension

The enforcement of the quality function under the principle of international exhaustion raises even more serious issues which cast doubts on the use of trade mark rights to restrict free movement of goods and thereby distorts competition. In the next part, we explore these issues in detail.

5.1 Overview of the Problem

¹⁰⁴ Advocate General Opinion Ruiz-Jarabo Colomer in Case C- 206/01 *Arsenal Football Club v Matthew Reed* [2002] ETMR 82, AG 42, 43.

¹⁰⁵ *Ibid.*

¹⁰⁶ *Ibid.*, 42, 43, 46, 47.

The TFEU neither requires nor prohibits a doctrine of international exhaustion of trade mark rights.¹⁰⁷ Prior to the passage of Directive 89/104 (replaced by Directive 2008/95), it was for individual Member States to apply international exhaustion. Some Members such as Germany, in the case of economically connected entities, and the UK, in the case where the quality of imported goods was the same of those sold on the market in the UK, had indeed imposed international exhaustion. At that era, it was held that case law under Articles 34- 36 (ex Articles 28- 30) could not be transposed to imports from third countries.¹⁰⁸ The Commission's original proposal to approximate the laws of the Member States relating to trade marks also indicates that the Commission would have imposed international exhaustion where the trade mark owner would not have been permitted to prevent further commercialization of goods which had been marketed anywhere in the world.¹⁰⁹

It is against this backdrop that this part questions the Court of Justice's variable legal tolerance to parallel trade by systematically challenging the manner in which the Court has enforced the essential function of the mark and arguing that the reluctance to oppose the international exhaustion principle lacks proper justification and is not consistent with the Court of Justice justifications for establishing exhaustion in the first place. Next part will examine the enforcement of the quality guarantee prior to and after the Directive.

5.2 The Pre Directive 2008/95 Era, the Commission's Position: Support for International Exhaustion

The first proposed Community legislation on exhaustion reveals that exhaustion was directly related to the trade mark function, a badge of origin. This principle was intended to prevent the use of trade mark rights as obstacles to free movement of goods and services in the Community.¹¹⁰ Originally, the position was that the owner of the mark does not have a right to impose a third party's use of the mark in relation of goods marketed *within or outside* the Community. This suggests that there was no

¹⁰⁷ Stothers (n 1) 334.

¹⁰⁸ Case 51/75 *E.M.I. Records Limited v CBS United Kingdom Limited* [1976] 2 CMLR 235.

¹⁰⁹ The explanatory Memorandum of the Proposal for a First Council Directive to Approximate the Laws of the Member States Relating to Trade Marks COM (1980) 635 final, 59, 60.

¹¹⁰ *Ibid*, 59.

intention to differentiate between intra- and extra market sales.¹¹¹ The explanatory Memorandum of the proposal provides that:

The obligation of establishing such a system [a system of undistorted competition in the Common Market]... could clearly not be observed if the Commission were to propose rules laying down the principle that the proprietor of a Community trade-mark had the right to use it in order to compartmentalise the world market, because there was... a real danger that undertakings whose principal place of business could well be in a non-Member country would prevent their products from being imported into the Community at more favourable prices, which would be detrimental to Community consumers.¹¹²

However, the Commission was considerably pressured to retain trade marks as a means of preventing parallel importing.¹¹³ The Economic and Social Committee opposed the adoption of international exhaustion particularly ‘where the marked goods to be imported into the Community differ in quality from goods which are marketed in the Community under the same marks’ or ‘where the non-member country bans the import of comparable goods from the Community’.¹¹⁴ The European Parliament’s Committee on Economic and Monetary Affairs also argued against the adoption of international exhaustion explaining that to “adopt an attitude based purely on the law relating to trade marks would lead to undesirable results from the point of view of commercial policy”.¹¹⁵ The prohibition of international exhaustion was, to a large extent, based on ‘the concern that third countries would not reciprocate but would allow the owners of IP rights in those countries to block parallel imports’.¹¹⁶ Subsequently, the Commission changed its position and limited the scope of exhaustion to goods that had been put on the market in the Community.¹¹⁷

5.3 The Enforcement of the Quality Function

¹¹¹ Id.

¹¹² Ibid, 59, 60.

¹¹³ Cornish and Llewelyn (n 1) 772.

¹¹⁴ [1981] OJ C 310/22, 24, and 30 cited in C Stothers, ‘Parallel Trade and Free Trade Agreements’ (2006) 1 *JIPL* 583.

¹¹⁵ Parliament Document 1 611/83/Corr., August 31, 1983, 61.

¹¹⁶ C Stothers, ‘Parallel Trade and Free Trade Agreements’ (2006) 1 *Journal of Intellectual Property Law* 584.

¹¹⁷ Stothers (n 1) 336- 337.

Prior to the adoption of Directive 2008/95, some Member States applied international exhaustion. Next we consider two leading examples.

5.3.1 *Cinzano*- The German Approach

Before the adoption of the Directive, Germany adapted international exhaustion in relation to all economically connected firms. In *Cinzano* (Before the First Civil Senate), the holder of the trade mark right in the country of import, a group of linked subsidiaries considered by the Court as a single group for the purpose of exhaustion of rights, could not oppose goods which have been sold in one Member State from being resold and freely traded across the frontiers. This is because, according to the Court, the function of the mark is to serve as an indication of origin and it should not be used for the purpose of isolating the national markets and thereby impeding international trade.¹¹⁸

The facts in this case were as follows. A West German subsidiary of the Italian Cinzano company registered several trade marks using the word ‘Cinzano’. The marks were virtually identical to the Italian company's own trade marks, also registered in the Federal Republic. The West German subsidiary imported Italian Cinzano in bulk, bottled it and marketed it in Germany. The bottle is associated by the public with Italian Cinzano. A Spanish subsidiary of the Italian company imported and marketed into Hamburg bottled Cinzano vermouths, produced in Spain and in France under licence from the Italian company. The Spanish and French Cinzano bottles bore labels very similar to those sold in Germany by the German subsidiary. The West German subsidiary argued that marketing of Spanish and French Cinzano violated its trade mark rights and interfered with the guarantee of quality and origin of the mark. Subsequently, Cinzano Germany was not entitled to use its trade mark rights to prevent importation of Cinzano vermouth made by a Spanish subsidiary or the French exclusive licensee.¹¹⁹ It was held that:

The extension of the so-called principle of exhaustion in trade mark law to matters which occur abroad, and in which no use is made, through internal acts of utilisation of the trade mark monopoly reserved internally, thus rests on the consideration that it is irrelevant for the correctness of the indication of origin incorporated in the trade mark *whether the owner of the internal trade mark has brought the goods on to the market in the same country or abroad,*

¹¹⁸ *Cinzano v Java Kaffeegeschäfte* (n 44) para 5.

¹¹⁹ *Ibid.*

provided only—and this is decisive—that it is he himself who has marked them and put them on the market. The Court abides by this view of the law.¹²⁰ (Emphasised added)

As to the quality guarantee, the Court held that a trade mark owner must not be permitted to use the quality function to prevent resale of goods. It pointed out:

It is true that a so-called guarantee function also additionally attaches to a trade mark in the sense that a consistent quality is always expected under the same trade mark. This guarantee function, however, as the Landgericht explains in more detail, is not protected by trade mark law, so that the owner of the trade mark cannot resist the import of goods which he has marked identically, by invoking his right to the trade mark, even if their quality differs from that of the goods which he himself markets internally.¹²¹

Thus, as long as the essential function of the mark, a badge of origin, is not impaired, the owner of the trade mark right cannot oppose further commercialization of goods put on the market anywhere in the world by him or with his consent. International exhaustion applies even where the quality of goods sold under the mark varies.

5.3.2 The UK Approach

In the United Kingdom the enforcement of the international exhaustion principle depended on whether the quality of goods sold inside the UK market differs from those sold outside it.

5.3.2.1 *Revlon*: The Same Quality Goods

The principle of international exhaustion was adopted in the United Kingdom *only* where the quality of imported goods was the same as those sold inside the UK. In *Revlon v Cripps & Lee*, after facing financial difficulties and subsequently closing down, a shampoo manufacturer sold part of its stocks in the US. As a result, it could not prevent the importation of the shampoo into the UK.¹²² This is because the Court of Appeal found that there was no misrepresentation as to the source of the United States products in question on account of the fact that the United Kingdom products had been sold in bottles bearing the words “REVLON/ New York and therefore disclosed their international source. The Court took the view that:

¹²⁰ Id.

¹²¹ Ibid, 2.

¹²² *Revlon Inc. and Others v Cripps & Lee Ltd. and Others* [1980] FSR 85, at 100, 101.

There was no misrepresentation as to the quality or composition of the United States products in question on account of the fact that in his opinion the evidence did not establish any relevant distinction between the United Kingdom products and the United States products in question. He thought the latter were merely a variant of the former for a different type of hair.¹²³

According to the Court of Appeal, the principal function of a trade mark is to serve as a badge of the origin of goods. Hence, ‘the products sold by the defendants [trade marks owners] are what the defendants say they are’.¹²⁴ The Court appeared to be saying that the use of registered trade marks to prevent the importation of goods bearing a particular trade mark where the goods were originally marketed by some branch of the enterprise should not be permitted. This is particularly true where the quality of goods sold inside the UK was the same as those sold outside it thus the essential function of the mark, a badge of origin, was not impaired.

5.3.2.2 *Colgate*: Different Quality Goods

In the United Kingdom, the principle of international exhaustion was not applied in the UK where the quality of imported goods was different from those sold inside the UK market. A good example is *Colgate*. In this case, the main question was the ability of a multi-national group, which uses the same mark and the same worldwide presentation to cover different qualities of goods in different countries, succeed in an action against an importer who brought in low quality goods from abroad and marketed them alongside higher quality goods in the United Kingdom.¹²⁵ The facts in this case were as follows.

Colgate-Palmolive Company (Colgate U.S.) was the parent company of a group of international companies engaged in the business of manufacturing and supplying toothpaste in over 50 countries. Colgate-Palmolive Limited (Colgate U.K.) was a wholly-owned subsidiary of Colgate U.S. The mark COLGATE had been used for many years in the United Kingdom in relation to toothpaste and dental cream which contained sodium monofluorophosphate and, in later stage, sodium fluoride. The product was manufactured and supplied by Colgate U.K. In addition to its main

¹²³ Ibid.

¹²⁴ Ibid, 112.

¹²⁵ *Colgate-Palmolive v. Markwell Finance* [1989] RPC 497.

brand, 'Colgate Great Regular Flavour', in January 1983 Colgate U.K. had introduced a second brand known as 'Colgate Blue Minty Gel'. Both brands were supplied in a number of sizes contained in plastic tubes except for the smallest size for which the tubes were made of aluminium. Then Colgate U.K. introduced a third brand, 'Colgate Tartar Control Formula' and in July 1986 a fourth brand was introduced, 'Colgate Junior'. Colgate U.K. had incurred very large expenditure in promoting the four brands and sales, particularly of the first two brands, had been very large. Colgate U.K.'s advertising emphasised the benefits of their toothpaste: clean teeth, fresh breath and protection against tooth decay. Colgate U.K. had been the sole registered user of the marks and it was known, in particular when used printed in white upon red packaging, as a Colgate U.K. product.

The Colgate subsidiary in Brazil was Colgate-Palmolive Limitada. The latter was licensed by Colgate U.S. to use the various COLGATE marks in Brazil. Limitada was also permitted to export COLGATE to Bolivia, Paraguay and Chile. In addition, Limitada sold to Brazilian export trading companies for export to countries where there was no Colgate subsidiary, in particular Nigeria. A parallel importer had imported into and sold and supplied in the United Kingdom two kinds of toothpaste manufactured by Limitada which, due to economic conditions, contained local Brazilian chalk rather than imported dical, and a number of other cheaper raw materials had been substituted for preferred constituents.

In the course of establishing the trade mark essential function, the Court of Appeal (the Court) upheld the fact that consumers view trade marked products as a sign of consistent quality. Because the quality of the Brazilian toothpastes was inferior to that of the toothpastes of Colgate U.K consumers are:

likely to be misled by the get-up of the two Brazilian toothpastes into thinking that these toothpastes not only emanated from the same source but were of the same quality as Colgate's U.K. toothpastes.¹²⁶

The Court of Appeal went on to clarify the fact that the public are likely to believe that UK Colgate has imported these products from abroad, presumably bearing the same mark and therefore conveying the same quality. It held that consumers are aware of the fact that:

¹²⁶ Ibid, 503.

...COLGATE toothpaste products emanating from the same source as the COLGATE toothpaste products they knew of and will expect them to be fluoride toothpastes and of the quality they associate with the COLGATE toothpaste products of which they know and are familiar, e.g. those manufactured and marketed by Colgate U.K.¹²⁷

The Court continued pointing out that consumers usually understand or anticipate from the trade marked goods under the origin function can maintain a consistent level of quality by saying:

...a trader, by applying a U.K. registered trade mark to goods and thereby indicating their origin, gives an assurance to consumers in this country that the *goods are of the quality which they have come to expect* from products bearing that trade mark.¹²⁸ (Emphasis added)

In other words, the origin function of the mark should be used to protect consumer expectations as to the quality of branded goods.

5.4 The Post Directive 2008/95 Era: *Silhouette* and the End of International Exhaustion

After the adoption of Directive 2008/95 (former Directive 89/104, a great deal of ink has been spilt on the pros and cons of imposing international exhaustion. After all, Article 7 of the Directive is confined to products marketed inside the EEA. Hence, in the case where a product is imported from outside the Union and has not yet been placed on the market in the EEA with the consent of the trade mark owner, Article 7 does not provide clear guidance.¹²⁹ The impact of this legal uncertainty is clearly evident in relation to the enforcement of the quality function where the goods placed on the market outside the Union.

The question of importing goods into the Community that were first marketed by a trade mark proprietor outside the Community has been considered by the ECJ in a number of cases including *Silhouette*.¹³⁰ The facts of this case were as follows. Silhouette sold 21,000 fashion spectacle frames to a Bulgarian company at the time where Bulgaria was not a Member State. The frames were imported to Austria by Hartlauer where they were offered for low price. Silhouette sought an injunction on the ground that it had not consented to their frames being put on the market in the

¹²⁷ Ibid, 509.

¹²⁸ Ibid, 527.

¹²⁹ Bently and Sherman (n 73) 955.

¹³⁰ *Silhouette v Hartlauer* (n 6).

European Economic Area (EEA) and had therefore not exhausted its rights under Council Directive 89/104 (the Directive). The problem however was that, prior to implementation of the Directive, Austrian law provided that a proprietor's rights were exhausted when the product was put onto the market *anywhere* in the world. Further, Hartlauer contended that Art.7 of Directive 89/104 left the door open to Member States to make provision for exhaustion in respect of products placed on the market outside the EEA. The ECJ was asked whether Article 7 (1) of the Directive meant that a trade mark owner has the right to prohibit a third party from using the mark for goods which have been put on the market outside the Community.

The ECJ held that according to the text of Article 7 (1) itself, exhaustion of trade mark rights occurred only where products had been put onto the market by a proprietor in the Community. Article 7 (1) did not provide for international exhaustion of rights, nor did it leave the Member States themselves free to provide for international exhaustion.¹³¹ The ECJ agreed that the Directive does not appear to require full-scale approximation, instead it provided for harmonisation of the substantive rules which most directly affected the internal market.¹³² However, in light of the first, third and the ninth recitals of the Directive, Articles 5 to 7 of the Directive were to be construed as completely harmonising the rules relating to the rights conferred by a trade mark.¹³³

In *Zino Davidoff SA v A&G Imports Ltd*,¹³⁴ the ECJ reaffirmed its position on exhaustion. It made it very clear that the Community legislature 'did not leave it open to the Member States to provide in their domestic law for exhaustion of the rights conferred by a trade mark in respect of products placed on the market in non-member countries'.¹³⁵ In *Zino Davidoff*, the ECJ was asked in three references by the English High Court to consider the circumstances under which the manufacturer can be taken to have implicitly consented to further commercialization within the Community of goods which were put on the market in a third country. Laddie J was particularly critical of the ECJ ruling in the *Silhouette* by saying that the ECJ judgement has

¹³¹ Ibid, 26- 27.

¹³² Ibid, 23.

¹³³ Ibid, 23- 26.

¹³⁴ *Zino Davidoff v Imports* (n 19).

¹³⁵ Ibid, 32, 33.

‘bestowed on a trade mark owner a parasitic right to interfere with the distribution of goods which bears little or no relationship to the proper function of the trade mark right’.¹³⁶

Laddie J’s frustration is quite understandable. It is difficult to justify the ECJ attitude concerning exhaustion. The ECJ restricted the protection of trade mark to its essential function to limit the impact of trade mark rights on free movement of goods. However, the ECJ severely breached the essence of that principle by allowing a trade mark owner to oppose the resale of goods put on the market by him or with his consent even where the essential function of the mark is not impaired.

5.4.1 Should a System for International Exhaustion be Introduced? A Quality Perspective

After the adoption of Directive 89/104 (now Directive 2008/95), the Commission was asked in the European Parliament whether the Directive had been intended to prohibit international exhaustion and if not whether the Commission would reconsider its position. The Commission’s reply was that the Directive intended to prohibit international exhaustion. The Commission later added that Community exhaustion ‘is likely to have certain advantages for the consumers’. In particular, ‘it can guarantee the sustained quality of the products moving around the internal market’.¹³⁷

In 1998 and when asked how far sustained quality depended on a prohibition of international exhaustion, on the basis that products sold by trade mark owners in the Community are often produced outside the Community anyway, the Commission noted that the quality of goods vary between countries and thus allowing ‘international exhaustion could mean that a consumer living in the Community might find that a parallel importer of the product differs from that to which he is accustomed.’¹³⁸ After *Silhouette* (discussed above) and considering the ECJ’s enforcement of the trade mark’s essential function, it became very clear that the refusal to impose international exhaustion has very little to do with protecting consumers’ expectations as to the quality of branded goods. From *Hoffmann- La*

¹³⁶ *Zino Davidoff S.A. v A. & G. Imports Ltd.* [2000] Ch. 127, para 36.

¹³⁷ Written Question P- 0737/98 [1998] OJ C 304/153; [1998] OJ C 402/25; *Stothers* (n 1) 348.

¹³⁸ Written Question P- 3726/98, answered by Commissioner Bolkestein on April 2000 [2000] OJ C330E/172.

Roche to Silhouette,¹³⁹ the ECJ held that the essence of the essential function of the mark is to enable the owner of the mark full control over the quality of the products for which he should be held accountable. By opposing parallel importation even where the quality of imported goods is identical to those sold in the Community (and thus the origin function of the mark is unlikely to be impaired), the ECJ has breached its own principles stating that the use of trade mark rights to repeal the importation of goods will contribute to artificial partitioning of markets if the essential function of the mark is not damaged.¹⁴⁰

In 1999, the Commission had requested National Economic Research Associates, the NERA institute, to examine the economic consequences for the European Union of alternative regimes for the exhaustion of trade mark rights.¹⁴¹ According to the report, trade marks perform two mutually dependent functions: to help the consumer to identify the source and quality of goods and to reward the trade mark owner for his investment in product development and product quality and for their expenditure in creating brand image.¹⁴² Limiting the scope of exhaustion to the Community is important if trade marks are to stay effective in helping consumers to identify the quality and origin of goods.¹⁴³ However, the report did not explain how the prevention of international exhaustion would benefit consumers particularly where the imported goods are of the same quality as those sold in the Community. Subsequently, considering the finding of the report, the Commission concluded that there was to be no change to the rule of Community exhaustion. The Report was criticized for being biased towards brand owners.¹⁴⁴

In 2003, the Commission working paper also concluded that there was no evidence of deficiencies in current legal provisions relating to possible abuse of trade marks within the EU.¹⁴⁵ As before however, the Commission failed to explain the benefits of

¹³⁹ *Hoffmann- La Roche v. Centrafarm* (n 31) para 7; *Silhouette v Hartlauer* (n 6) and most recently in *Copad v Christian Dior* (n 85) para 22.

¹⁴⁰ *Bristol-Myers v Paranova* (n 5) para 49.

¹⁴¹ NERA, SJ Berwin and IFF Research, *The Economic Consequences of the Choice of Regime of Exhaustion in the Area of Trade Marks* (NERA, London 1999).

¹⁴² *Ibid.*, 3.

¹⁴³ *Ibid.*, 6.

¹⁴⁴ *Stothers* (n 1) 349.

¹⁴⁵ Commission of the European Communities, *Possible abuses of trade mark rights within the EU in the context of Community exhaustion* (2003) SEC575, 17.

imposing international exhaustion where these identified function are not damaged. The decision not to apply international exhaustion is difficult to defend. Some pointed out that the decision to use trade marks as buttresses of a “fortress Europe” has been a political choice.¹⁴⁶ Obviously, consumers may lose out particularly where the prices of the same quality goods outside the Community are cheaper than those inside it.¹⁴⁷

To conclude, the decision not to apply international exhaustion does not fit easily with the underlying policy of the law. Trade marks are protected to indicate the source of goods and services and thereby to guarantee their qualities. As we have already seen, the Court of Justice repeatedly stated that trade mark rights must not be used to artificially partition the markets or for the sake of maintaining price maintenance. Keeping that in mind, a question must be raised: Considering the essence of protecting the essential function of the mark and therefore the main goal for establishing exhaustion, how can the prevention of importing genuine goods into the Community be justified where the essential function of the mark, a badge of origin, is not affected? Is it not the case that the use of trade mark rights to prevent parallel importation where such an act does not affect the essential function of the mark might have the equivalent effect of enforcing artificial price maintenance and artificial partitioning of the Community markets from international markets?

5.4.2 Quality Enforcement Deficiency: Competition Law as a Possible but not Adequate Solution

The Commission’s working paper concerning possible abuses of trade mark rights within the EU concluded that the exercise of trade marks is restricted by competition law and therefore there were no deficiencies in the current legislation.¹⁴⁸ This part will critically investigate this statement. The reader must remember however that the goal of this discussion is not the interaction between trade mark rights and competition law. Rather, the focus will be on whether there is a gap between competition law and

¹⁴⁶ Cornish and Llewelyn (n 1) 801.

¹⁴⁷ Manufacturers however supports prices differentials because it may cost more to invest and launch a quality product in higher-priced market or the product might not be put in the cheaper market in the first place if international exhaustion is applied. See in general C Baudenbacher, ‘Trade Mark Law and Parallel Imports in a Globalized World- Recent Developments in Europe with Special Regard to the Legal Situations in the United States’ (1999) 22 *Fordham Intl L J* 645- 666 .

¹⁴⁸ Commission of the European Communities (n 145) 9- 17.

trade mark law where the lack of quality enforcement might raise cause for concern. In other words, this part investigates whether the lack of quality enforcement might result in some anti-competitive effects that are prohibited under competition law, being permitted under trade mark law. To this end, the following two examples will be considered.

5.4.2.1 *E.M.I. v CBS*

It has long been accepted that the act of dividing the external market from the Community market could be in breach of Article 101 of the TFEU.¹⁴⁹ In *E.M.I. Records v CBS United Kingdom*,¹⁵⁰ the ECJ dealt with the question of whether the exercise of a trade mark right in order to prevent the marketing of products coming from a non-member country under an identical mark, even if this constitutes a measure having an effect equivalent to a quantitative restriction, does not affect the free movement of goods between Member-States and thus does not come under the prohibition set out in 34. In this case, the Mark COLUMBIA for records was separated and given to EMI in EC countries and to CBS in the Americas. The question was whether trade mark law in the United Kingdom, Denmark and the then West Germany could be used by EMI to prevent imports of CBS COLUMBIA records by a CBS subsidiary and an independent importer without violating the free movement of goods policy for the reason that it is stated to operate only upon trade between Member States.

The Court of Justice first agreed that neither the rules of the TFEU on the free movement of goods nor those on the putting into free circulation of products coming from third countries prohibit the proprietor of a mark from exercising his right in order to prevent the importation of similar products bearing the same mark and coming from a third country.¹⁵¹ The ECJ held that preventing the marketing of products coming from a third country under an identical mark does not ‘affect the free movement of goods between member States’ because it ‘does not in fact jeopardize the unity of the common market which Articles [34] et seq. are intended to ensure’.¹⁵²

¹⁴⁹ It is important to notice that Article 101 does not prohibit action which seeks to prohibit parallel trade unless there is an agreement or concerted practice.

¹⁵⁰ *E.M.I. v CBS* (n 108).

¹⁵¹ *Ibid*, 21.

¹⁵² *Ibid*, 8- 10.

However, the ECJ went on to warn that if the trade mark barrier to entry to any part of the Common Market was the ‘subject, the means, or the consequence of a restrictive practice’, Article 101 could be violated. The European Court of Justice pointed out:

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A restrictive agreement between traders within the Common Market and competitors in third countries that would bring about an isolation of the Common Market as a whole which, in the territory of the Community, would reduce the supply of products originating in third countries and similar to those protected by a mark within the Community, might be of such a nature as to affect adversely the conditions of competition within the Common Market.¹⁵⁴

Surely, if a restricted agreement between traders inside and outside the Union may reduce the supply of goods in the Union and therefore distort competition, then certainly the use of the trade mark origin function to prevent the importation of goods originating in third countries which have the same or similar quality to those sold inside the Union does bring about an isolation of the Common Market and thereby affects adversely the condition of competition. Accordingly, such an act, which cannot be prevented under Article 101, must not be permitted under trade mark law. Otherwise, the trade mark right may be used as an obstacle to free movement of goods and services in the Union.

5.4 .2.2 *Javico v Yves*

In *Javico v Yves Saint-Laurent*, the ECJ dealt with the importation of ‘YSL’ from East Europe.¹⁵⁵ The product had been sold there under an express condition that the purchaser was to resell *only* in Russia and the Ukraine. The ECJ was asked whether Article 101(1) of the Treaty precludes a supplier established in a Member State from prohibiting a distributor established in another Member State to which it entrusts the distribution of its products in a territory outside the Community from making any sales in a territory other than the contractual territory, including the territory of the Community, either by means of direct sales or by means of re-exportation from the contractual territory. The ECJ held that if the purpose or effect of the ban on supplies

¹⁵³ Ibid, 27.

¹⁵⁴ Ibid, 28.

¹⁵⁵ Case C- 306/96 *Javico International and Javico AG v Yves Saint Laurent Parfums SA* [1998] 5 CMLR 172.

which they entail is to restrict to an appreciable extent competition within the Common Market and if the ban may affect trade between Member States, it may be caught by the prohibition contained in Article 101(1) of the Treaty.¹⁵⁶ The ECJ pointed out that agreements apply within the Community which are intended to deprive a reseller of his commercial freedom to choose his customers by requiring him to sell only to customers established in the contractual territory is restrictive of competition within the meaning of Article 101(1) of the Treaty.¹⁵⁷ The ECJ added that an agreement which requires a reseller not to resell contractual products outside the contractual territory has as its object the exclusion of parallel imports within the Community and consequently restriction of competition in the Common Market constitutes by its very nature a restriction of competition.¹⁵⁸ Such a contractual prohibition would be in breach of Article 101 where the:

Community market in the products in question is characterised by an oligopolistic structure or by an appreciable difference between the prices charged for the contractual product within the Community and those charged outside the Community and where, in view of the position occupied by the supplier of the products at issue and the extent of the supplier's production and sales in the Member States, the prohibition entails a risk that it might have an appreciable effect on the pattern of trade between Member States such as to undermine attainment of the objectives of the Common Market.¹⁵⁹

Another important issue to remember is that Article 101 prohibits agreements between undertakings and does not apply where the act of partitioning of the markets or prices maintenance is committed by a single entity.¹⁶⁰ For this, Article 102 must be invoked. To breach this Article, an undertaking must, *inter alia*, abuse its dominant position. In *Bundesverband der Arzneimittel v Bayer*, the ECJ allowed non-dominant entities unilaterally to limit the supply of their products to wholesalers within a Member State in order to prevent them from exporting the goods to another Member State.¹⁶¹

¹⁵⁶ Ibid, 11, 12.

¹⁵⁷ Ibid, 13.

¹⁵⁸ Ibid, 14.

¹⁵⁹ Ibid, 28.

¹⁶⁰ R Whish, *Competition Law* (5th edn, Lexis Nexis, London 2003) 79.

¹⁶¹ Joined Cases C-2/01 P and C-3/01 P *Bundesverband der Arzneimittel-Importeure eV and Commission of the European Communities (Sweden and Another, intervening) v Bayer AG* [2004] 4 CMLR 13, para 70.

In *Parke Davis v Probel* the question of abuse was raised.¹⁶² The European Court of Justice considered the situations under which the exercise of patent rights could be an abuse of dominant position. The ECJ held that the exercise of IP rights may be enjoined under Article 102 when used as an instrument of abuse and where trade between Member States may be affected.¹⁶³ In *Syfait v GlaxoSmithKline*, the AG found that the refusal by a dominant pharmaceutical company to fulfil all orders from wholesalers *does not* automatically constitute an abuse of a dominant position.¹⁶⁴ This is despite the fact that such a refusal clearly limits parallel trade of the products in question. According to the AG, such a restriction ‘does not protect price disparities which are of the undertaking’s own making, nor does it directly impede trade’.¹⁶⁵ Given the special economic characteristic of the pharmaceutical industry, a ‘requirement to supply would not necessarily promote either free movement or competition, and might harm the incentive for pharmaceutical undertakings to innovate’.¹⁶⁶

To sum up, competition law can be invoked to curb the use of a trade mark rights to artificially partition the markets. However, there are still some trade mark activities that *might* have as their object the exclusion of parallel imports within the Union and consequently restriction of competition which cannot be prevented under competition law. Examples include the use of the trade mark’s essential function to repeal parallel importation under the grounds of providing the owner of the mark full control over the quality of his goods where the trader himself does not maintain the quality of his goods. Another example is where the trade mark essential function is used to prevent the importation of similar or identical quality goods originated in a third country into the Union even where the essential function of the mark is not impaired.

6. Overview

The question of how one might reconcile tensions between trade mark protection and free movement of goods comes down to the question of the proper interpretation of

¹⁶² *Parke v Probel* (n 22).

¹⁶³ *Ibid.*, 4; for general information about this issue see Maniatis and Botis (n 1) 792.

¹⁶⁴ Advocate General Opinion in Case C- 53/03 *Synetairismos Farmakopoion Aitolias & Akarnanias (Syfait) and Others v GlaxoSmithKline plc*[2005] 5 CMLR 1, AG 100.

¹⁶⁵ *Ibid.*

¹⁶⁶ *Id.*

the trade mark subject-matter and, more specifically to the essential function of the mark. The economic rationale of identifying the trade mark subject-matter is clear. It seeks, on the one hand, to prevent the use of trade mark rights to artificially partitioning the markets between Member States thus maintain price differentials and, on the other, to reward the manufacturer who consistently produces high quality goods and thus stimulate economic progress. That is why the force of the quality function should be implemented not only against parallel importers in general but also against the traders themselves.

Finally, it is important not to lose sight of the fact that trade mark protection is intended to serve traders and consumers alike. To achieve an appropriate balance, one needs to look beyond the doctrine of a trade mark subject-matter. Given the lack of legal justifications for not applying international exhaustion, one cannot be blamed for thinking that the interests of consumers as to quality issues are used as a vehicle to enhance the rights of the trade mark owner.

Chapter Three: Quality, The Protection of Non-Origin Functions: Putting Dilution into Context

1. Introduction

The previous chapter has looked at the quality guarantee under the doctrine of the trade mark subject-matter. It has investigated the principle of protecting the essential function of the mark.¹ The main goal has been to examine the visibility of the origin-oriented module of trade mark protection to achieve the objectives of the law, namely promoting competition and reducing consumer search costs without the need to enforce the quality guarantee by law.

This chapter will examine the enforcement of the quality function in the case of marks with a reputation. It has long been accepted that the protection of a reputable mark should not be restricted to its essential function, a badge of origin. The function of this mark is usually seen as something that goes far beyond the mere indication of origin or quality.² In his elegant and prescient article, Schechter argued that the uniqueness of the trade mark should constitute ‘the only rational basis for its protection’.³ As such, the protection of the mark should not be limited to its use in the market as a product identifier. Rather, this protection should be extended to a non-trade mark subject matter, such as a trade mark selling power or its reputation. Expanding the protection of marks with a reputation is thought to enhance competition and reduce consumer searching costs.⁴

¹ See in general A Papandreou, ‘The Economic Effect of Trademarks’ (1956) 44 California L Rev 503; M Leaffer, ‘Sixty Years of the Lanham Act: The Decline and Demise of Monopoly Phobia’ in H Hansen, (ed.) *US Intellectual Property Law and Policy* (Edward Elgar, Cheltenham 2006) 86. Leaffer argues that the protection of the trade mark on the property model can be understood within the boundaries of three dimensional changes that have taken a place recently. That is, a new marketing technique, new economic learning and finally an inexorable push for international harmonization in global commerce, at 90.

² Case C- 59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40, paras 24- 26; Case C- 487/07 *L'Oréal SA v Bellure NV* [2009] ETMR 55, para 58; F Schechter, ‘The Rational Basis of Trademark Protection’ (1927) 40 Harvard L Rev 813; Leaffer (n 1).

³ Schechter (n 2) 831.

⁴ Ibid, 813; W Landes, and R Posner, ‘Trade Mark Law: An Economic Perspective’ (1987) 30 J L and Economics 265- 273; Leaffer (n 1) 90; 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; Case C- 337/95 *Christian Dior SA and Another v. Evora BV* [1998] 1 CMLR 737, para 45; C- 48/105 *Adam Opel AG v Autec AG* [2007] ETMR 33; A Breitschaft, ‘Intel, Adidas &Co-Is the Jurisprudence of the European Court of Justice on Dilution Law in Compliance with the Underlying Rationales and Fit for the Future?’ (2009) 10 EIPR

The trouble with the notion of protecting non-trade mark subject-matters rests on the justification of this protection. That is, the dilution doctrine downplays the significance of confusion as a ground for trade mark liability and focuses on the need for the protection of the interests of a trade mark owner.⁵ As such, protecting consumers against confusion or securing their expectations regarding quality issues are not the main concern. Rather, the main goal is the protection of the selling power of the mark.

It is the purpose of this chapter to examine the extent to which maintaining consistent quality does impact the scope of trade mark protection under the dilution doctrine. Accordingly, this chapter is divided into five parts. It begins with an examination of the pros and cons of preventing dilution. This part reveals that preventing dilution is mainly about protecting the investment made by the trade mark owner. To this end, the law protects the relationship between a mark with a reputation and a particular product, particularly, the way consumers perceive that reputation in the context of that relationship: a sign of quality.⁶ Thus, despite the fact that dilution is mainly about protecting the selling power of the mark, regard has to be paid to the question of quality.

Parts two and three of this chapter will then look at how the present law of trade marks shapes the boundaries of protection by not limiting the protection of a branded product to its physical components thus considering the presentation of certain luxury goods or their aura of luxury as protectable subject matters. This chapter then will go on consider Schechter's concept of expanding the protection of the reputable mark in the light of the traditional grounds of trade mark protection. The initial results reveal that the tradeoff between the costs and benefits of expanding the protection of the mark with a reputation goes far towards explaining one dynamic that has driven the expansion of trade mark protection. At the heart of this dynamic is the assumption that the expansion of protection for the selling power of the mark or its reputation can be justified under the grounds that this expansion enhances competition and consumer

497; S Maniatis, and A Sanders, 'A consumer trade mark: protection based on origin and quality' (1993) 15 EIPR 406.

⁵ See in general F Schechter, *The Historical Foundations of the Law Relating to Trade-Marks* (Columbia University Press, New York 1925) 164- 166.

⁶ *Loendersloot v George Ballantine* (n 4); *Cnl-Sucal v Hag*, (n 4); *Bristol-Myer v Paranova* (n 4).

welfare. As such, Schechter's concept of protection is not always sustainable. For example, should the distinctiveness of the mark be protected even where such distinction is not based on real economic value that justifies the protection in the first place? How can the expansion of protection for the selling power of the mark or its reputation be justified if the product sold under the mark is no different from what is already available in the market? Further, the selling power of the mark can be a formidable anti-competitive weapon if built on the mark itself rather than on the product to which it is attached. In this case, protecting the selling power of the mark or its reputation would enhance artificial product differentiation and distort competition. When consumers become less sensitive to lower prices of other substitute products and buy everything that goes under the trade mark, the latter becomes an anti-competitive tool. This is because consumers would be less interested in product differentiation. Rather, they would be interested in the mark's singularity or distinctiveness. There is nothing wrong with consumers being attracted to the mark rather than to the product to which it is affixed. However, the protection of the mark in this case does not enhance competition neither does it increase consumer welfare. Hence, expanding the protection of the mark with a reputation can only be justified where the selling power of the mark or its reputation leads to economic efficiency by differentiating, among many other things, the quality of one product from other substitutable products. The need to give substance to the quality function under the dilution doctrine therefore goes beyond whether or not to enforce the quality function by law. It concerns the policy underpinning trade mark protection in the first place. When shaping the scope on trade mark protection therefore, one has to consider carefully matters of policy including the purpose of protecting trade marks in order to determine whether the law should simply react to how traders brand or present their branded goods or whether instead the law should seek to actively influence the commercial behaviour of traders and more importantly how.⁷

The final part of this chapter begins with an in-depth analysis of the potential risk of expanding the monopoly power of the mark if Schechter's concept of protection is not properly investigated. This part shows an increasing trend to separate the selling power of the mark or its reputation from the product to which it is attached. To this

⁷ A recent discussion which notes a similar question is made by G Dinwoodie, 'Trademark Law and Social Norms' (2007) <<http://www.oiprc.ox.ac.uk/documents/EJWP0207.pdf>> accessed 27 June 2010.

end, economically irrational elements are introduced into consumer choices. This, in turn, means that the mark's appeal to consumers is independent of the quality or the price of the product. As such, the owner of the mark enjoys an excessive level of trade mark monopoly. Expanding the protection of the selling power of the mark in this case enhances artificial product differentiation and distorts competition.

The objectives of this chapter are two fold, first to highlight the fact that the selling power of the mark plays a key role in retaining the loyalty of consumers. At the same time, it expands the monopoly power of a trade mark owner. This can only be justified if the selling power of the mark is linked to the specifications of the branded goods. Otherwise, the protection of the distinctiveness of the mark could distort competition by enhancing artificial product differentiation. Thus, Schechter's argument that the preservation of the uniqueness of a trade mark should constitute the only rational basis for its protection can *only* be justified where such uniqueness does contribute to economic efficiency thus the production of quality goods. Secondly, the fact that the main focus of dilution is to protect the investment of a trade mark owner should not render the notion of protecting the interests of consumers and the way they perceive the mark redundant. Protecting the selling power of the mark as suggested by Schechter would simply encourage traders to enhance the advertising value of the mark rather than improving the quality of their branded goods, which should not be tolerated under trade mark law.

1.1 The Trouble with Dilution

The trouble with the doctrine of dilution is that it rests on unstated assumptions about how trade marks work, and, because of its assumptions, it might be granting marks with a reputation too much monopoly in return for too little. Almost all aspects of dilution are divisive. Examples include expanding the scope of protection for marks with a reputation, the protection of the intangible values of these marks, the daunting task of justifying such an extended level of protection in the light of the traditional goals of the law. Cast as a trade mark policy, reputation protection has influenced expansions of trade mark law. The most troubling of which are linked to a broad conception of reputation that includes artificial elements unrelated to the trade marked

product.⁸ As we progress through this chapter, the impact of such policy in distorting competition becomes evident.

In order for a mark to qualify for extra protection, it must have a reputation. The legal impact of having a reputation cannot be overstated. The ECJ has ruled that when determining trade mark liability, account has to be taken of the distinctive character of the mark, in particular its reputation. The greater the reputation of the mark, the wider the domain of protection.⁹ Recently, the ECJ pointed out that the more immediately and strongly the mark is brought to mind by the sign, the greater the likelihood that the current or future use of the sign is, or will constitute taking unfair advantage of the distinctive character or the repute of the mark.¹⁰

Thus, establishing a trade mark reputation may have very significant legal implications. On the one hand, the owner of a reputable mark will enjoy an extra level of protection under Article 5(2) of Directive 2008/95. On the other, the burden of proof under Article 5(2) will loosen since, as the ECJ pointed out, the stronger the earlier mark's reputation the easier it will be to accept that detriment affected without due cause has been caused to it.¹¹

Considering the profound impact of establishing a reputation in increasing the level of protection for trade marks, the following questions should be raised: when we say the protection of a trade mark non-subject-matter such as a reputation, what do we mean by that? What does the notion of a trade mark reputation mean when it comes to trade mark functions?

In the followings the rationales for including dilution protection in the law and the challenges to these rationales will be analysed as these will form the basis of several arguments during the further course of discussion.

⁸ *Copad v Christian Dior* (n 2); see in general R Bone, 'Hunting Goodwill: A History of the Concept of Goodwill in Trademark Law' (2006) 86 Boston U L Rev 592- 593, 616- 621.

⁹ Case C- 39/97 *Canon Kabushiki Kaisha v Metro-Goldwyn-Mayer Inc.* [1999] 1 CMLR 77, paras 22-24.

¹⁰ *L'Oréal v Bellure* (n 2) para 44; Case C- 252/07 *Intel Corp Inc v CPM United Kingdom Ltd* [2009] ETMR 13, para 67.

¹¹ *Ibid.*

1.2 Expanding Protection for Marks with a Reputation

Not that long ago, a trade mark was considered not to be a subject of property except in connection with an existing business.¹² As a result, the goodwill of the mark could only be derived from the specific goods or services to which it is attached. As such, a significant function of a trade mark is to link goods or services to a source of supply. In this context, Article 5 (1) of Directive 2008/95 (and Article 9 (1) (a) and (b) of Regulation 207/2009) regulates the protection of identical or similar marks in relation to identical or similar goods. This Article is seen as sufficient as a general rule.

In today's market however, some marks are thought to have a value that goes far beyond the product they represent. These marks are particularly vulnerable to the existence of similar marks even in highly dissimilar product areas. These marks are thought to perform as a powerful image of quality, exclusivity, youth, fun and luxury. In this case, the role of a trade mark is not necessarily associated with a specific product. Rather, the mark is capable of presenting a strong marketing message in itself.¹³ Accordingly, the mark becomes the focal point of communication with consumers. The aim of protecting such function is to secure a safe return to the investment made by the owner of the mark rather than to prevent public confusion.¹⁴ That is why in many cases the mark itself not the product to which it is affixed becomes the essence of protection. This explains why the subject-matter of dilution is not based on the idea of preventing confusion. Rather, it is based on the notion of protecting the selling power of the mark.¹⁵

The concept of dilution was first articulated by Schechter in 1927.¹⁶ Shechter advocated protection against injury to a trade mark owner going beyond the injury caused by use of an identical or similar mark in relation to identical or similar goods

¹² *Hanover Star Milling Co. v Metcalf* (1916) 240 US 403, 414.

¹³ Advocate General Opinion E Sharpston in Case C- 252/07 *Intel Corp Inc v CPM United Kingdom Ltd* [2009] ETMR 13, AG 5- 10; see also the Advocate General Opinion R Jarabo in Case C- 206/01 *Arsenal Football Club Plc v Read* [2002] ECR I-10273, AG 46, 47; Advocate General Opinion Jacob in Case C- 408/01 *Adidas-Salomon AG and Another v Fitnessworld Trading Ltd* [2004] 1 CMLR 14, AG 36- 39.

¹⁴ See in general Advocate General Opinion *Intel v CPM* (n 13) AG 17; M Senftleben, 'The Trademark Tower of Babel- Dilution Concepts in international , US and EC Trademark Law' (2009) 40 IIC 45.

¹⁵ S Diamond, 'Trademark Dilution: of Fame, Blurring, and Sealing Wax, with a Touch of Judicial Wisdom' (2008) 24 Santa Clara Computer and High Tech L J 524.

¹⁶ Schechter (n 2).

or services causing confusion as to origin. He described the type of injury with which he was concerned as the ‘gradual whittling away or dispersion of the identity and hold upon the public mind’ of certain marks.¹⁷ Schechter believed that dilution-based infringement is superior to the confusion-based one and that is how he came to the conclusion that ‘the preservation of the uniqueness of a trademark should constitute the only rational basis for its protection’.¹⁸ The problem however is that the justifications of trade mark protection under the confusion theory might be different from those under the dilution doctrine. The subject of protection under these two different approaches is not the same. As noted before, under the trade mark subject-matter doctrine, the protection of the mark is restricted to its core function, a badge of origin. The goal is to enable a trade mark owner to have full control over the quality of the product for which he should be held accountable.¹⁹ Under the dilution doctrine, the protection of the mark is not restricted to its core function. It is believed that a mark with a reputation is able to raise a desire for a product regardless of any assumption about its quality. In this context, the role of the mark shifts from indicator of origin and thereby quality to become more of a marketing tool.²⁰ As such, the scope of monopoly granted to a trade mark owner is much wider than that granted under confusion. Next we examine the practical and legal justifications for expanding protection for marks with a reputation.

1.2.1 Practical Justifications

Expanding the scope of protection for marks with a reputation is usually justified on a number of grounds. One of the arguments put forward is the economic deficiency of a registration system. That is, protecting the reputation of the mark is understood to enhance the investment value of the mark and the product to which it is attached. Such wide scope of protection, however, cannot be maintained through the traditional boundaries of the registration system. This is because it is partially impossible to register the mark with a reputation for all tradable goods or services. Economically, it

¹⁷ Ibid; see also S Casparie-Kerdel, ‘Dilution disguised: has the concept of trade mark dilution made its way into the laws of Europe?’ (2001) 23 EIPR 186.

¹⁸ Schechter (n 2) 831; R Bone, ‘Schechter’s Ideas in Historical Context and Dilution’s Rocky Road’ (2008) 24 Santa Clara Computer and High Tech L J 477.

¹⁹ Chapter two, 15- 19.

²⁰ T Drescher, ‘The Transformation and Evolution of Trade Marks- from Signals to Symbols to Myth’ (1992) 82 TMR 301, 309- 321.

is not a workable scenario since the additional costs of looking after the mark will be unbearable. As one observer points out:

The most famous marks are not used everywhere and cannot be registered and maintained in all the places and for all the categories in which infringement may arise. It is strange, but true, that most owners of famous marks are living beyond their means in the defence of their trade marks, in the sense that they must spend where they do not earn.²¹

That is why it is important to expand the scope of legal protection for the mark with a reputation not only for similar and dissimilar goods or services but also for products it does or it does not seek to exploit commercially in the foreseen future.²² The problem with this argument, however, is that it ignores the costs of preventing other competitors from using the mark. Put differently, it neglects the impact of expanding the protection of marks on competition by mainly focusing on the interest of the trade mark owner.

Another argument put forward is that preventing dilution reduces consumer searching costs. Dilution decreases the distinctiveness of an established trade mark. This means that it takes more time and, therefore, it costs more money for the consumer to recognize the original mark and the products to which it is attached. For example, using the same mark for multiple sorts of goods or services might 'dilute the distinctive quality of the mark'. This makes it difficult for consumers to recall the experience they associate with the mark.²³ This, in turn, is thought to increase consumer searching costs.

Nevertheless, persuasive empirical evidence suggests that the increase in searching cost in such a case is trivial and in no way justifies the economic costs of restricting competition that may result from the expansion of the level of legal protection afforded for marks with a reputation.²⁴ Further, as we have just mentioned above, trade mark protection under the dilution doctrine is not necessarily related to the origin function. The reputable mark is protected for its own value not for its role as a

²¹ R Lehman, 'Reputation Without Use and Household Names' (1986) 3 *Trademark World* 18- 27.

²² J Phillips, *Trade Mark Law: a Practical Anatomy* (OUP, Oxford 2003) 364.

²³ Schechter (n 2) 813; D Klerman, 'Trademark Dilution, Search Costs, and Naked Licensing' (2006) 74 *Fordham L Rev* 1762.

²⁴ R Bone, 'A Skeptical View of the Trademark Dilution Revision Act' (2007) 11 *IPL Bull* 188- 194; see also R Tushnet, 'Gone in 60 Milliseconds: Trademark Law and Cognitive Science' (2008) 86 *Texas L Rev* 507.

product identifier. That is why the notion of expanding the protection of mark with a reputation is still a hotly debated topic. Recognising the difficulties of justifying the expansion of trade mark protection under traditional policy grounds, some have turned their attention to a different corner. They simply argue that preventing dilution can be justified as a way of preventing competitors from taking unfair advantage of the seller's goodwill.²⁵

The lack of a persuasive argument makes the concept of dilution one of the most troublesome aspects of contemporary trade mark law. It simply diverts its way from the traditional objectives of trade mark law.²⁶ It is very difficult to economically justify the cost of protecting the reputation of the mark unless there is a clear and tight link between the mark with a reputation and the specifications of the product to which it is attached.²⁷

1.2.2 Legal Justifications

It has long been accepted that a mark with a reputation has value which transcends the product to which it is affixed and this value should be protected. One can imagine how if 'Dior' was protected only in respect of perfumes, the distinctiveness of the mark could be eroded if it were used by others in respect of a host of unrelated products.²⁸ The reputation of Dior could be also harmed if the mark was used for substandard cosmetic products.²⁹ Thus, marks with a reputation have much wider appeal than normal marks and as such their role goes beyond the traditional boundaries of functionality. As one observer stated:

...the trademark is not merely the symbol of goodwill but often the most effective agent for the creation of goodwill, imprinting upon the public mind an anonymous and impersonal guaranty of satisfaction, creating a desire for further satisfaction. The mark actually sells the goods. And, self-evidently,

²⁵ D Franklyn, 'Debunking Dilution Doctrine: Toward a Coherent Theory of the Anti-Free-Rider Principle in American Trademark Law' (2004) 56 *Hastings L J* 138- 143.

²⁶ M Lemley, & E Volokh, 'Freedom of speech and Injunctions in Intellectual Property Cases' (1998) 48 *Duke L Rev* 216- 217.

²⁷ Chapter one, 26- 29.

²⁸ See in general I Fhima, 'Dilution by blurring- a conceptual roadmap' (2010) 1 *IPQ* 44- 87; see also I Fhima, 'Dilution in the US, Europe, and beyond: international obligations and basic definitions' (2006) 1 *JIPLP* 406.

²⁹ This concept is quite controversial. It is a sort of implied likelihood of confusion which is totally different from the concept of dilution itself as a way of damaging the mark without the need to establish confusion; see R Nelson, 'Unraveling the Trademark Rope: Tarnishment and its Proper Place in the Laws of Unfair Competition' (2002) 42 *J L and Technology* 133- 136.

the more distinctive the mark, the more effective is its selling power...³⁰ The more distinctive or unique the mark, the deeper is its impression upon the public consciousness, and the greater its need for protection against vitiation or dissociation from the particular product in connection with which it has been used.³¹

Hence, some marks with a reputation have extra value which can be added to the products on offer. Marks that 'once functioned solely as signals denoting the source, origin, and quality of goods, have become products in their own right, valued as indicators of the status, preferences, and aspirations of those who use them'.³² This added value is termed by some observers as a 'brand value'.³³ The term 'brand' value has been defined as 'a wider concept intended to attract consumer loyalty by virtue of values, including lifestyle messages, associated with that brand'.³⁴ The mark that acquires brand values enjoys a very strong competitive position. That is:

The difference between products and brands is fundamental. A product is something made in a factory; a brand is something bought by a consumer. A product can be copied by a competitor; a brand is unique. A product can be quickly outdated; a successful brand is timeless.³⁵

Marks with a reputation (brands) therefore are understood to have a quality of 'transferability', in a sense 'they have the ability to transfer consumer loyalty between products, services and categories over time and to separate it from tangible production'.³⁶ This, in turn, means that those brands, marks with a reputation, are often deemed to have something more than trade marks as they are usually defined.³⁷ According to one observer, 'a useful way to conceptualise a brand is as an aggregation of assets which includes, but is not limited to a trade mark'.³⁸ In that sense, a brand can be:

³⁰ Schechter (n 2) 819.

³¹ Ibid, 825.

³² J Kozinski, 'Trademarks Unplugged' (1993) 68 New York U L Rev 965.

³³ J Davis, 'Between a sign and a brand: mapping the boundaries of a registered trade mark in European Union trade mark law' in L Bently, J Davis and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 80.

³⁴ R Sumroy, and C Badger, 'Infringing "Use in the Course of Trade"' in J Phillips, and I Simon, (eds) *Trade Marks Use* (OUP, Oxford 2005) 164; H Norman, 'Time to blow the Whistle on Trade Mark Use' (2004) 1 IPQ 1.

³⁵ S King cited in D Haigh, *Brand Valuation: Understanding, Exploiting and Communicating Brand Values* (Financial Times, London 1998) 8.

³⁶ D Haigh, *Brand Valuation: Understanding, Exploiting and Communicating Brand Values* (Financial Times, London 1998) 1.

³⁷ Davis (n 33) 81.

³⁸ G Smith, *Trade Mark Valuation* (Wiley & Sons, New York 1997) 42.

A combination of legal rights, together with the culture, people, and programs of an organization within which the specific logo and associated visual elements plus the larger bundle of visual and marketing intangibles' and the 'associated goodwill are deployed.³⁹

The notion of protecting the intangible values of a mark raises serious issues, in particular, the legal impact of granting a broad scope of monopoly on competition. Preventing dilution of a trade mark reputation is much more difficult to reconcile with the economic rationales for protection discussed before. This issue is examined below.

1.3 The Costs of Expanding Protection for Marks with a Reputation

Article 5 (2) of Directive 2008/95 grants the owner of a reputable mark some kind of extra protection. This additional protection provides a trade mark owner more monopoly on the exploitation of its mark.⁴⁰ In some cases, the impact of such a monopoly in restraining competition becomes very evident. Examples include the case where the goods marketed by the proprietor and his competition are not similar,⁴¹ or where the proprietor's mark contains descriptive words.⁴² Providing extra protection for a mark with a reputation may also impose extra cost on small businesses which, in comparison with big companies, might either not be able to promote their marks to gain reputation or they might struggle to submit sufficient evidence for an existing reputation such as expensive consumer surveys.⁴³ But perhaps the most troubling question is how to justify the protection of the mark's selling power or its reputation in gross or where linked to artificial components of the product.

On the one hand, as we discussed before, trade mark protection is usually justified under the ground of protecting competition thus the production of quality goods.⁴⁴ On the other, the protection of the distinctive character of the mark or its reputation is not

³⁹ D Haigh, and J Knowles, 'Don't waste time with brand valuation' *Marketing NPV* (2004) <www.brandfinance.com> accessed 20 June 2010.

⁴⁰ Senffleben (n 14) 47- 48.

⁴¹ E Hunt, and L Kemp, 'Three Challenges for the ECJ' (2008) 179 *Managing Intellectual Property* 115.

⁴² R Kunstadt, 'Trade marks: not just for the rich and famous' (2008) 3 *JIPLP* 454- 455.

⁴³ *Ibid*, 453- 454.

⁴⁴ Chapter one, 14, 20- 22.

necessarily related to the association consumers make between the quality of goods sold under the proprietor's mark but to the mark's singularity. The lack of quality factor would mean that the expansion of protection for the selling power of the mark is used as a tool to hammer any potential competitor and yet without providing *real* economic benefits in return.⁴⁵ In such a case, the protection of a trade mark reputation would actually enhance artificial product differentiation. The act of preventing dilution is not carried out in accordance with the traditional boundaries of protection since it imposes liability upon other competitors without any requirement of confusion.⁴⁶ This makes it very difficult to economically justify the protection of a trade mark reputation. Thus, the significance of understanding how reputable marks should act if the law is to achieve its object cannot be overstated. Only then one might be able to specify the extent to which reputable marks should be protected and in which context. If left unchecked, the protection of marks under dilution might have anti-competitive effects.

2. Dilution: the Framework of the Law

After giving an overview of the rationales of dilution protection, in this part we investigate the Court of Justice Jurisprudence concerning dilution law. According to recital 10 of the preamble of Directive 2008/95, a Member States may grant more extensive protection to trade marks which have a reputation. In similar terms, Article 5 (2) (and Article 9(1) (c) of Regulation 207/2009) allows Member States to give the owner of a reputable trade mark some kind of extra protection. For the benefit of trade marks with a reputation, Article 5 (2) establishes a form of protection whose implementation does not require the existence of a likelihood of confusion and applies to situations in which the specific condition of the protection consists of a use of the sign in question without due cause which takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark.⁴⁷ In order for that to work, a mark, *inter alia*, must have:

- a reputation in the Member State; and
- the use of the opponent's sign is detrimental to the distinctive character;

⁴⁵ Ibid, 26- 29.

⁴⁶ *L'Oréal v Bellure* (n 2) H8; Case C- 292/00 *Davidoff v. Gofkid*, [2003] 1 CMLR 35, H6- 10; Bone (n 8) 547- 558.

⁴⁷ Case C- 102/07 *Adidas AG v Marca Mode CV* [2008] ETMR 44, para 40.

- or the reputation of the trade mark
- without due cause.

In explaining the implications of these acts, we will explore the nature of the protection enjoyed by a trade mark by virtue of its reputation. The goal is to investigate whether trade mark law is moving towards granting marks with a reputation a great monopoly and, if so, the impact of this extensive level of protection on competition.

2.1 *Motors Corporation v. Yplon*: Establishing Reputation

For a mark to fall under the scope of Article 5 (2) of Directive 2008/95, it must have a reputation in the Union. In *General Motors v Yplon*, the European Court of Justice had a chance to clarify this term.⁴⁸ In this case the General Motors Corporation, the owner of the registered Benelux trade mark ‘Chevy’, brought legal proceedings against the use of its mark by the Yplon, who had also obtained a registered Benelux trade mark for ‘Chevy’, but for a different group of goods. General Motors argued that dilution of its mark was caused by Yplon’s use of the Chevy mark. Yplon defended its position by questioning the reputation of General Motors trade mark within the Benelux countries. As a result, the ECJ was asked to provide guidance on the interpretation of reputation within Article 5 (2).

The ECJ held that a mark ‘would have a reputation where it was known by a significant part of the public concerned by the products or services covered by the trade mark.’⁴⁹ This should be assessed by considering all the relevant facts of each case, in particular the market share held by the trade mark, the intensity, geographical extent and duration of its use and the size of the investment made by the proprietor in promoting it.⁵⁰ In the terms of Article 5 (2) of the Directive, the trade mark is not required to have a reputation throughout the territory of a Member State and it is sufficient for it to exist in a substantial part of it.⁵¹ Then the ECJ observed that when examining the

⁴⁸ Case C- 375/97 *General Motors Corp v Yplon SA* [1999] ETMR 950.

⁴⁹ *Ibid*, 26- 27.

⁵⁰ *Id*.

⁵¹ *Ibid*, 28.

other conditions laid down in Article 5 (2), it should be observed that the ‘stronger the earlier mark’s distinctive character and reputation the easier it will be to accept that detriment has been caused to it’.⁵² Put differently, establishing a strong trade mark reputation not only will enable a trade mark owner to have more protection for its mark under Article 5 (2) but also it will make it easier for him to establish the conditions laid down by this Article.

2.2 *Adidas-Salomon v Fitnessworld* and Beyond: Type of Association

What kind of similarity between the proprietor’s mark and the opponent’s sign is necessary to justify a dilution action? In *Adidas-Salomon v Fitnessworld*, the ECJ gave some advice on this issue. In this case, Adidas claimed that the defendant had infringed its registered three-strip trade mark by providing sports clothing with two parallel stripes. The defendant argued that there was no trade mark infringement as the two parallel stripes were used just for decorative purposes and not as a sign of origin. The ECJ explicitly held that confusion is not a requirement within art.5 (2) of Directive 89/104 (now Directive 2008/95).

... the protection conferred by Art.5(2) of the Directive is not conditional on a finding of a degree of similarity between the mark with a reputation and the sign such that there exists a likelihood of confusion between them on the part of the relevant section of the public. It is sufficient for the degree of similarity between the mark with a reputation and the sign to have the effect that the relevant section of the public establishes a link between the sign and the mark.⁵³

The ECJ went on to say that the use of a sign as an embellishment does not automatically exclude dilution protection unless the relevant public perceives the sign as a pure decorative element and is not reminded of the proprietor’s trade mark at all. In this case, there will be no room for dilution protection.⁵⁴

⁵² Ibid, 30.

⁵³ Case C- 408/01 *Adidas-Salomon v Fitnessworld* [2004] 1 CMLR 14, para 31. The ECJ upheld its position in *Adidas v Marca Mode* (n 47) 40- 41. The circumstances in both cases were similar. Even under Article 5 (1) of the Directive, it is easier to establish similarity between signs thus a link as the ECJ held in *Adidas v Marca Mode* that:

The more the mark is well known, the greater the number of operators who will want to use similar signs. The presence on the market of a large quantity of goods covered by similar signs might adversely affect the trade mark insofar as it could reduce the distinctive character of the mark and jeopardise its essential function, which is to ensure that consumers know where the goods concerned come from; Case C-102/07 *Adidas AG v Marca Mode CV* [2008] ETMR 44, para 36.

⁵⁴ *Adidas-Salomon v Fitnessworld* (n 53) para 41; *Adidas v Marca Mode* (n 47) 34.

In *Adidas* however, the ECJ did not give specific guidance on the quality of the link required to establish that the marks are similar. In *Intel Corp v United Kingdom*, the ECJ had a chance to do so.⁵⁵ In this case the Intel Corporation, owned registered trade marks in the United Kingdom containing the word INTEL for computer and computer-linked goods and services. It claimed for invalidity of the opponent's mark INTELMARK, registered for marketing and telemarketing services. Intel argued that the unique nature and the high reputation of the INTEL sign automatically established a link between its mark and the opponent's sign. The ECJ first pointed out that evidence for actual confusion or for a likelihood of confusion proves the existence of a link. However, such a high standard of connection between the reputable mark and the opponent's sign is not necessary under 5 (2).⁵⁶ Then the ECJ observed that it 'is tantamount to the existence of such a link' if the opponent's sign 'would call the earlier mark to mind' of the reasonably well informed and reasonably observant and circumspect consumer.⁵⁷

2.3 Unfair Advantage

Article 5 (2) (and Article 9 (1) (c) can be invoked if it can be shown that the use of a sign would take unfair advantage of the earlier mark. The goal is to enable a trade mark owner to prevent the use of a similar mark when to do so would involve a free ride on the reputation of the earlier mark.⁵⁸ The term unfair advantage was addressed in *L'Oréal v Bellure*.⁵⁹ This case concerned the sale of look-alike products sold under a trade mark similar to certain *L'Oréal* brands. The case also concerned the use of comparison list by the retailers of these look-alikes. The UK Court of Appeal submitted a request for preliminary ruling to the ECJ regarding the notion of 'unfair advantage'. The ECJ was asked, *inter alia*, whether Article 5 (2) meant that a third party which used a sign similar to a trade mark with a reputation was taking unfair advantage of the earlier mark where such use gave that party an advantage in the marketing of its goods or services regardless of whether or not such use would create a likelihood of confusing the relevant public or risk detriment to the mark or to its proprietor.

⁵⁵ *Intel v CPM* (n 10).

⁵⁶ *Ibid*, 57- 58. The ECJ came to the same conclusion in *L'Oréal v Bellure* (n 2) 37.

⁵⁷ *Inte v CPM* (n 10) 60.

⁵⁸ AG Opinion (n 13) AG 39.

⁵⁹ *L'Oréal v Bellure* (n 2).

The ECJ held that Article 5 (2) of Directive 89/104 (now Directive 2008/95) must be interpreted as meaning that the taking of unfair advantage of the distinctive character or the repute of a mark relates to the advantage arising from the use by a third party of a sign similar to a mark with a reputation to ride on ‘the coat-tails of the mark with a reputation’ in order to benefit from the power of attraction, the reputation and the prestige of that mark without bearing the costs of creating and maintain the mark’s image.⁶⁰ In this regards, the unfair advantage is not related to the harm caused to the trade mark or the trade mark owner. The ECJ also held that an advantage taken by a third party of the distinctive character or the repute of the mark may be unfair, ‘even if the use of the identical or similar sign is not detrimental either to the distinctive character or to the repute of the mark or, more generally, to its proprietor’.⁶¹

The ECJ went on to add that when determining whether the use of a sign takes unfair advantage of its distinctive character or repute, all factors relevant to the circumstances of the case must be taken into account (a global assessment). These include the strength of the mark’s reputation and the degree of distinctive character of the mark, the degree of similarity between the marks at issue and the nature and degree of proximity of the goods or services concerned.⁶² As regard the strength of the reputation and the degree of distinctive character of the mark, the ECJ held that the more immediately and strongly the mark is brought to mind by the sign, the greater the likelihood that the current or future use of the sign is taking, or will take, unfair advantage of the distinctive character or the repute of the mark.⁶³

2.4 Detrimental to the Distinctive Character of the Earlier Mark: Dilution or Blurring

In *Adidas-Salomon v. Fitnessworld*, the ECJ clarified the meaning of blurring. The ECJ termed the concept of detriment to the distinctive character of a trade mark as dilution.⁶⁴ According to the ECJ, blurring of the distinctiveness of the mark means

⁶⁰ Ibid, 41.

⁶¹ Ibid, 43.

⁶² Id, 44.

⁶³ Id.

⁶⁴ *Adidas-Salomon v. Fitnessworld* (n 53) 37- 40; T Martino, *Trademark Dilution*, (OUP, Oxford 1996) 43- 46.

that it is no longer capable of ‘arousing immediate association with the goods for which it is registered and used’.⁶⁵

In *Intel Corp v United Kingdom* (discussed before), the ECJ held that in order to establish the existence of a detrimental effect, a proprietor must give specific evidence for one of the dilution alternatives mentioned in Article 5 (2) of Directive 2008/95.⁶⁶ The ECJ added that the more immediate and stronger the earlier mark is brought to mind by the later sign, the greater is the likelihood of a detrimental effect to the distinctive character of the earlier mark.⁶⁷ To establish this point, a global approach that takes into account all the factors, in particular the reputation and the degree of distinctiveness of the earlier mark must be undertaken.⁶⁸ The ECJ further required the owner of the earlier mark to provide evidence for actual and present injury to its mark or a serious likelihood that such an injury will occur in the future.⁶⁹ It is not sufficient to simply establish that the use of the later mark takes or would take unfair advantage of, or would be detrimental to, the distinctive character of the earlier mark. The ECJ pointed out that:

proof that the use of the later mark is or would be detrimental to the distinctive character of the earlier mark requires evidence of a change in the economic behaviour of the average consumer of the goods or services for which the earlier mark was registered consequent on the use of the later mark, or a serious likelihood that such a change will occur in the future.⁷⁰

Interestingly, the ECJ did not mention the alternative basis for infringement, unfair advantage (free riding). It remains to be seen how the ECJ will interpret the concept of changing a consumer’s economic behaviour.

2.5 Damage to Reputation: Tarnishment

In *Adidas-Salomon v. Fitnessworld*, the ECJ defined the concept of detriment to the repute of a trade mark as ‘degradation or tarnishment of the mark’ in such a way that the trade mark’s power of attraction is affected.⁷¹ The damage to a trade mark occurs

⁶⁵ *Adidas-Salomon v. Fitnessworld* (n 53) 37- 40.

⁶⁶ *Intel v CPM* (n 10) 70- 71.

⁶⁷ *Ibid*, 67.

⁶⁸ *Ibid*, 68.

⁶⁹ *Ibid*, 77.

⁷⁰ *Id*.

⁷¹ *Adidas-Salomon v Fitnessworld* (n 53) 38. Section 15 U.S.C.A, 1125 (C) (2) (B) of the American Trademark Dilution Revision Act of 2006 defines tarnishment as ‘association arising from the

if its subsequent use reflects badly on its reputation. This could occur where the goods for which the infringing sign is used appeal to the public's senses in such a way that damages the trade mark's power of attraction.⁷² A good example could be the modification of COCA COLA mark to COCAINE. This could tarnish the image of COCA COLA by suggesting that it contains cocaine.⁷³ To prove the damage, a trade mark owner must establish that the negative association with the earlier mark will be real. This does not only involve establishing the existence of a particular image in the earlier mark but to clarify the way in which the later mark will bring about the damage.⁷⁴ Otherwise, there will be no tarnishment. In *Daimler v Alavi*, for instance, the High Court of Justice found that the use of MERC was not detrimental to the repute of the claimant for high quality engineering because nothing would actually rub off on the MERC or Mercedes sign. The Court held:

... no objection to the defendant's use of the sign MERC can be made out on this ground. I consider that in order to succeed under Article 5(2)... it must be shown that there is established in the mind of the relevant public a connection between the mark with which they are familiar and the disparaging use. Thus it is not sufficient to see the word MERC, note that this is the word which one uses to refer to Mercedes cars, see the disagreeable web-site and register it as disagreeable, if nothing actually rubs off on the sign MERC itself or on MERCEDES, or on DaimlerChrysler. I was not satisfied that this was the case here, and so this allegation of infringement fails.⁷⁵

One of the good examples in which the question of tarnishment was addressed is *Hollywood v Souza Cruz*.⁷⁶ In this case, the OHIM Third Board of Appeal pointed out that a trade mark is tarnished when:

...it is linked with goods of poor quality which evoke undesirable or questionable mental associations which conflict with the associations or image generated by legitimate use of the trade mark by its proprietor [or when] it is linked with goods which are incompatible with the quality and prestige associated with the trade mark, even though it is not a matter of inappropriate use of the trade mark in itself.⁷⁷

similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark?.

⁷² AG Opinion (n 13) AG 38.

⁷³ L Bently, and B Sherman, *Intellectual Property Law* (3rd edn, OUP, Oxford 2009) 888.

⁷⁴ *Daimlerchrysler v Javid Alavi* [2001] ETMR 98, para 94.

⁷⁵ *Ibid.*

⁷⁶ Case R 283/1999-3 *Hollywood v Souza Cruz* [2002] ETMR 64, para 86 (OHIM, Third Board of Appeal).

⁷⁷ *Ibid.*, 86- 87.

Then the Board made a clear link between the notion of tarnishment and the level of quality consumers associate with a trade marked product.

The detrimental effect could be that use of the trade mark for another type of product would make the trade mark less attractive for the products for which it is registered. This would be the case when this other type of products, although not per se having a negative influence on the public's perception, nevertheless influences it in such a way that the trade mark is detrimentally affected in terms of its capacity to stimulate the desire to purchase the goods for which it was registered. This leads to an erosion of distinctive character caused by the proliferation of "parasitic" trade marks which, although not debasing the original trade mark, are so numerous that they deprive the trade mark of its distinctive character and hence of its impact.⁷⁸

Another example of linking quality to reputation within the meaning of tarnishment under Article 5 (2) of the Directive can also be found in the *Adam Opel v Autec*.⁷⁹ In this case the European Court of Justice found that Autec's use of the Opel mark might infringe under the dilution provision of the TM Directive, as such use might tarnish the Opel mark especially if the toys were of poor quality.⁸⁰

Most recently, the ECJ made similar remarks in *L'Oréal v Bellure*. In this case the ECJ explained when tarnishment may occur holding that:

tarnishment is caused when the goods or services for which the identical or similar sign is used by the third party may be perceived by the public in such a way that the trade mark's power of attraction is reduced. The likelihood of such detriment may arise in particular from the fact that the goods or services offered by the third party possess a characteristic or a quality which is liable to have a negative impact on the image of the mark.⁸¹

To sum up, it should be understood that, in view of the spirit of trade mark law, the notion of preventing tarnishment means protecting the level of quality or social status the consumers associate with a product sold under a mark with a reputation. This association between the selling power of the mark and the product to which it is attached is what justifies granting marks with a reputation an extra level of protection in the first place.

2.6 Without Due Cause

⁷⁸ Ibid, 108.

⁷⁹ *Adam v Autec* (n 4).

⁸⁰ Ibid, 34- 37.

⁸¹ *L'Oréal v Bellure* (n 2) 40.

Once a trade mark owner has established that the use of its trade mark, which has a reputation, will take unfair advantage or, be detrimental to, the earlier mark, he then must show that the use would be without due cause. The interpretation of the term without due cause is not a crystal clear. There are few cases in which this term has been addressed. The best known example is perhaps to be found in the decision of the Benelux Court of Justice (the Court) in *Lucas Bols v. Colgate-Palmolive*.⁸² In this case the mark CLAERYN for gin was held to be infringed by use of the sign KLAREIN for a detergent. The Benelux Court had to consider situations where the use of the earlier mark might be without justifiable reason. The Court said the following:

It is ... possible ... that the goods to which [the use of] a similar mark relates, appealed to the sensations of the public in such a way that the attraction and the “capacity of the mark to stimulate the desire to buy” the kind of goods for which it is registered, are impaired.⁸³

The Court then clarified two cases where the use of another’s mark was itself justifiable. The first is where the use of the earlier mark was indispensable. The second is where the user had a legitimate right to use the sign in question.⁸⁴ Some useful guidance concerning the question of due cause can also be found in *Premier Brands*.⁸⁵ In this case, the High Court of Justice made it clear that Article 5 (2) is not intended to confer absolute rights on trade mark proprietors in all circumstances. The High Court identified two major facts which have to be fully appreciated when addressing the question of due cause. Firstly, regard has to be paid to the essence of Article 5 (2) which is the protection of the value and the goodwill of trade marks with a reputation from being unfairly taken advantage of or unfairly harmed.⁸⁶ Secondly, the term without due cause must be understood in line with the terms unfair advantages and detrimental to. The Court held:

... the words “being without due cause” are somewhat opaque in their effect, I consider that they have to be read as not merely governing the words “the use of the sign”, but also as governing the words “takes unfair advantage of, or is detrimental to”. Section 10(3) [corresponds to Article 5(2)] must be read in a commercially sensible way. Bearing in mind its overall purpose, it appears to me that it requires the defendant to show not merely that the use of the allegedly infringing sign in connection with the defendant’s goods is “with

⁸² *Lucas Bols v Colgate-Palmolive* (1976) 7 IIC 420.

⁸³ *Ibid*, 425.

⁸⁴ *Id.*

⁸⁵ *Premier Brands UK Ltd v Typhoon Europe Ltd & Another* [2000] ETMR.1071.

⁸⁶ *Ibid*, 1097.

due cause”; it also requires him to show that although the use of the sign might otherwise be said to “take unfair advantage of or is detrimental to” the mark, the advantage or detriment are not “without due cause”.⁸⁷

Having investigated the legal framework of dilution, next we will analysis the direction of the law in relation to the protection of reputable marks.

3. Marks with a Reputation before the Court: Where are we Going?

Indications that marks with a reputation enjoy an extended level of protection are not scarce. The Court of Justice has demarcated the protection of these marks in many areas; protection against registration⁸⁸ or use⁸⁹ by a third party in case of identical, similar or dissimilar goods or services.⁹⁰ Further, protection was granted against non-trade mark use by a third party. In *Arsenal v Reed*, the European Court of Justice seemed to offer protection for marks with a reputation against a use by a third party which was not in itself a trade mark use.⁹¹ Recently, the ECJ in *Adidas AG v Marca Mode CV*, pointed out that a trade mark infringement claim can be successful even where the registered mark is used for decorative purposes.⁹² The ECJ stated:

⁸⁷ *Id.*

⁸⁸ For instance, the ECJ has approved Audi’s application to register the word sign ‘Vorsprung durch Technik, as a Community trade mark. It found that the mere fact that a mark applied for is a laudatory slogan does not automatically mean that it is devoid of the distinctive character necessary to indicate the origin of goods and services; Case C- 398/08 *Audi AG v Office for Harmonisation in the Internal Market* [2010] ETMR 18.

⁸⁹ *Adidas-Salmon v. Fitnessworld Trading* (n 46); *Adam Opel v Autec* (n 4); *Adidas v Marca Mode* (n 47); and Case C- 533/06 *O2 Holdings Ltd v Hutchison 3G UK Ltd* [2008] ETMR 55, para 36. Most recently however, the ECJ ruled in joined Cases C- 236,237 and 238/08 *Google France, Google Ic. v Louis Vuitton Malletier* that the use of a sign identical with a trade mark as a keyword is not use within the meaning of Article 5 (1) and (2) of Directive 89/104 or of Article 9(1) of Regulation 40/94. Should a trade mark use be a requirement of any action for dilution of a trade mark? This is part of an interesting debate concerning the scope of trade mark protection. Dogan and Lemley have written of the need for trade mark use to be a requirement of any action for dilution of a trade mark. Such a requirement is necessary to restrict the rights of a trade mark owner to prevent any unauthorized use of its mark or a similar mark. In a usual trade mark infringement situation, the test of confusion limits the conferring rights in gross to trade mark owners. Since the test of confusion is not required under dilution claims, there is a risk of increasing rights in gross granted under dilution. S Dogan, and M Lemley, ‘The Trademark Use Requirement in Dilution Cases’ (2008) 24 *Santa Clara Computer & High Technology L J* 541-545. By contrast, Dinwoodie and Janis have argued against the need for a trade mark use requirement in standard infringement actions based on proof of confusion or its likelihood. One of the several criticisms put forward is that the test of trade mark use is virtually identical to a confusion test; G Dinwoodie, and M Janis, ‘Confusion Over Use: Contextualism in Trademark Law’ (2007) 92 *Iowa L Rev* 1646- 1650.

⁹⁰ *L’Oréal v Bellure* (n 2) H8- 10; *Adidas-Salomon v. Fitnessworld* (n 53) 37- 40.

⁹¹ Case C- 206/01 *Arsenal Football Club Plc v Matthew Reed* [2003] 1 CMLR 12.

⁹² *Adidas v Marca Mode*(n 47) 34.

...the public's perception that a sign is a decoration cannot constitute a restriction on the protection conferred by Article 5(1) (b) of the Directive, when despite its decorative nature, that sign is so similar to the registered mark that the relevant public is likely to perceive that the goods come from the same undertaking or, as the case may be, economically linked undertakings.⁹³

Most recently, the Court observed that the use by an advertiser of his competitor's registered mark for the purpose of identifying his competitor's goods, not his own, can still fall under the scope of Article 5 (1) and (2).⁹⁴

But perhaps the most troubling trend of all was revealed in the European Court of Justice ruling in *Copad v Christian Dior*.⁹⁵ In this case, the ECJ considered the allure and prestigious image of luxury products, which confer on them an aura of luxury aura, as part of their quality hence protectable subject-matters. Cast as a trade mark policy, the notion of expanding the protection of marks with a reputation might not be always consistent with the broader policy of the law particularly in the case of protecting artificial elements that could enhance artificial product differentiation. Next, we will track the roots and implications of such an approach.

3.1 *Dior*: Presentation as Part of the Quality of Goods

This case concerned the ability of a trade mark proprietor to rely on its trade mark rights under Directive 89/104 Article 5 and Article 7 (now Directive 2008/95) to prevent the advertising of goods placed on the market by him or with his consent particularly where that advertising damaged the luxury image of its brand.⁹⁶ In this case, the ECJ first considered the presentation of goods as part of their quality. The facts in this case were as follows. Perfumes Christian Dior France produced luxury perfumes and other cosmetic products, distributed through a selective system. Dior Netherlands was the sole representative for the distribution of Dior products domestically. The selective distribution system provided that the products may be sold only by selected retailers and on condition that those retailers supply only to ultimate consumers or other selected retailers. Dior France had registered a number of Benelux trade marks comprising illustrations of the packaging in which the bottles

⁹³ Ibid.

⁹⁴ *O2 v Hutchison* (n 89).

⁹⁵ *Copad v Christian Dior* (n 2).

⁹⁶ *Parfums Christian Dior v Evora* (n 4).

containing its products were sold. The defendants obtained quantities of the claimant's products by parallel importation and proceeded to advertise the goods by distributing promotional leaflets depicting the bottles and packaging of some of those products. Dior France objected to these forms of advertising since in its view they were liable to damage the luxurious and prestigious image of the Christian Dior trade mark. The Dutch Supreme Court referred a number of questions to the European Court of Justice which, *inter alia*, included whether, as a result of the manner in which the reseller uses the trade mark in order to attract public attention, he damages the luxurious and prestigious image of the goods, and hence the advertising function of the trade mark?

The ECJ stressed the importance of striking the correct balance between, on the one hand, the legitimate interest of the trade mark owner in being protected against resellers using his trade mark for advertising in a manner which could damage the reputation of the trade mark and, on the other, the reseller's legitimate interest in being able to resell the goods in question by using advertising methods which are customary in his sector of trade on the other.⁹⁷ The ECJ agreed to allow the owner of the mark with a reputation to prevent 'advertising by which a reseller sought to advertise his own undertaking by creating the impression that it was of a particular quality, thus taking advantage of the reputation and goodwill attached to the trade mark.'⁹⁸ The ECJ further added that advertising luxury goods must not affect the value of the trade mark by detracting from the allure and prestigious image of the goods in question and from their aura of luxury. The ECJ held:

... although the luxurious nature of such cosmetics derived from, *inter alia*, their high intrinsic quality, their higher price, and the manufacturers' advertising campaigns, the fact that the products were sold within the framework of a selective distribution system, which sought to ensure that they were presented in retail outlets in an enhancing manner, was also capable of contributing to that image. It accordingly considered luxury cosmetics worthy of the protection afforded by a selective distribution network. It can, therefore, be properly assumed for present purposes that the reputation of a trade mark for luxury cosmetics can, in principle, be damaged by marketing which detracts from its luxurious image.⁹⁹

⁹⁷ Ibid, 44.

⁹⁸ Ibid, 7.

⁹⁹ Ibid, 45.

The ECJ then went on to say that the proprietor of a trade mark may rely on Article 7 (2) of Directive 89/104 to oppose the use of the trade mark if such use seriously damages the reputation of the trade mark.¹⁰⁰

3.2 Dior 2009

In *Copad SA v Christian Dior*, the ECJ elaborated in more detail the interplay between quality and the presentation of luxury goods.¹⁰¹ This case concerned the resale by a licensee of luxury corsetry goods bearing the Christian Dior trade mark to downmarket traders. The licence agreement stated that in order to maintain the reputation and prestige of Dior trade mark, the licensee would not sell to particular companies such as discount stores without Dior's consent. Indeed, the luxury corsetry goods were to be distributed through a selective distribution network. In breach of that restriction, the licensee sold the goods to a discount store operator. The owner of the Christian Dior mark objected to the resale and filed a case before a French court. The Court referred a request for preliminary ruling to the ECJ to determine whether a provision in a license agreement prohibiting the licensee, on the ground of the trade mark's prestige, to sell the goods bearing the trade mark covered by the contract to discount stores, fell within the scope of art.8 (2) of Directive 89/104.

Regarding the quality of goods sold under the Christian Dior mark, the European Court of Justice found that the quality of luxury goods results not just from their physical characteristics but also from their allure and prestigious image which confer on the product an aura of luxury. This aura of luxury emanating from luxury goods is essential in that it enables consumers to distinguish them from similar goods. Hence, any impairment to that aura of luxury is likely to affect the actual quality of those goods.¹⁰² The ECJ also held that the characteristics and conditions of a selective distribution network can, in themselves, preserve the quality of luxury goods and ensure their proper use. Thus, the sale by the licensee of the luxury goods to parties that do not belong to the selective distribution network would conceivably affect the quality of these goods. The ECJ pointed out:

¹⁰⁰ Ibid, 48.

¹⁰¹ *Copad v Christian Dior* (n 2).

¹⁰² Ibid, 24- 26.

Setting up a selective distribution system such as that at issue in the main proceedings which, according to the terms of the licence agreement between Dior and SIL, seeks to ensure that the goods are displayed in sales outlets in a manner that enhances their value, “especially as regards the positioning, advertising, packaging as well as business policy”, contributes, as Copad acknowledges, to the reputation of the goods at issue and therefore to sustaining the aura of luxury surrounding them. It follows that it is conceivable that the sale of luxury goods by the licensee to third parties that are not part of the selective distribution network might affect the quality itself of those goods, so that, in such circumstances, a contractual provision prohibiting such sale must be considered to be falling within the scope of art.8(2) of the Directive.¹⁰³

One of the most important reflections of this case is that the image and prestige of luxury goods are important aspects of their quality. Therefore undermining the allure and prestigious image of luxury brands can constitute trade mark infringement.

3.3 Scrutinizing the ECJ Decision in *Dior*

It will have been apparent from reading previous chapters that there is an unending tension between expanding protection for the selling power of a reputable mark, in particular its reputation, and promoting competition.¹⁰⁴ It is widely accepted that, for a good segment of consumers, the quality of a luxury product depends not only on its physical characteristics but also on some artificial product differentiation techniques such as its aura of luxury or prestigious image. As such, from a trader point of view, it does make business sense to recognise that fact and thus to work hard to improve the advertising or the persuasive value of the mark. The problem however is that by considering the presentation of goods and their allure and prestigious images as protectable subject-matters, the Court of Justice might be unwittingly encouraging artificial product differentiation. Presentation, allure and prestigious image of goods (brand values) add very little to the product. The ECJ ruling in *Dior* could be understood as a green light for traders to build a reputation on the brand rather than on the product to which it is affixed. As we explained before however, maintaining and improving the quality of goods is the main assurance that trade mark protection does enhance competition and reduces consumer searching costs.¹⁰⁵ Hence, even if the prestigious image or presentation of a branded good might constitute its distinctive

¹⁰³ Id, 29- 30 and 55- 56.

¹⁰⁴ Chapter one, 28- 33.

¹⁰⁵ Ibid, 26- 29.

character or reputation, the protection of such economically artificial components does not necessarily enhance consumer rational commercial behaviour.¹⁰⁶ For many, the conclusions of the ECJ in *Copad v Christian Dior* were going to give rise to controversy. This should not come as a surprise given the fact that the previous judgment might indeed increase the risk of simply improving the advertising value of branded goods at the expense of their quality which is contrary to the legal and economic rationales of trade mark protection. This trend towards granting marks with a reputation extensive protection is not combined with a clear view as to how exactly and, in what context; does the protection of brand values contribute to the legal and economic objectives of the law. Given the impact of a trade mark reputation on retaining the loyalty of consumers thus expanding the monopoly power of a trade mark owner, this lack of guidance should raise cause for concern. The ECJ is therefore required to balance the protection of the quality of a product against other artificial components such as its prestigious image or presentation. The ECJ appears to agree with Schechter's notion of trade mark protection and thus with his argument that protecting the distinctiveness of the mark should be the only rational basis for protection. To this we shall now turn our attention.

4. Re-thinking Schechter's Concept of Dilution: A Quality Perspective

The growing judicial acceptance of expanding the protection of the publicity value (intangible values) of reputable marks seems to come at the expense of other much more important factors such as quality.¹⁰⁷ The assumption is that dilution is mainly about protecting the selling power of the mark thus consumer's concerns regarding quality issues might not be a priority. This notion seems to be used to systematically influence the law in favour of traders.

There appears to be only patchy legal consensus on what a brand value or a reputation is. Many examples indicate that these terms are being used to refer to the way consumers perceive the reputation of a mark: a connection between the mark and a

¹⁰⁶ Id.

¹⁰⁷ See in general J Schroeder 'Brand culture: trademarks, marketing and consumption' in L Bently, J Davis, and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 212.

certain level of quality.¹⁰⁸ The question to be raised here, therefore, is: does the expansion of protection afforded to the intangible values (brand values) of reputable marks at the expense of quality factors fall in line with the objectives of the Directive and therefore the essence of trade mark protection? Should the law be concerned mainly with providing legal cover for the selling power of the mark without considering what the law is intended to achieve in the first place and therefore how the selling power of the mark is built or used?

As already discussed, trade mark protection is justified under the grounds of fostering competition and reducing consumer searching costs.¹⁰⁹ The relationship between marks with a reputation and the increase in protection is understood to be mutually reinforcing competition and the interests of consumers. The more well-known the mark, the more distinctive it is, and the more protection it gets. Thus, the tradeoff between marks with a reputation, protection and reducing searching costs goes far towards explaining one dynamic that has driven the expansion of marks protection in the course of the twentieth century. At the heart of this dynamic is the assumption that the expansion of protection for the selling power of the mark or its reputation can be justified under the grounds that this expansion benefits the process of competition and hence consumers directly or indirectly. This by necessity requires that the selling power of the mark with a reputation should always be based on the features of the products to which it is attached.

Considering the legal and economic rationales of trade mark protection, Schechter's notion of dilution is clearly debatable. The protection of the distinctiveness of the mark cannot be justified where such distinction is not based on real economic value that justifies the restriction of competition that might be caused by such a protection. In many cases the presentation of goods or their prestigious images do not provide any meaningful difference to what is already available in the market. The illusory nature of the concept of protecting the distinctiveness of the mark threatens to destabilize the legal basis of trade mark protection.¹¹⁰ To tackle this issue, regard has to be paid to the fundamental goal of protecting a trade mark in the first place: to

¹⁰⁸ *Loendersloot v George Ballantine* (n 4); *Cnl-Sucal v Hag*, (n 4); *Bristol-Myer v Paranova* (n 4).

¹⁰⁹ Chapter one, 20- 22.

¹¹⁰ C NG, 'The irrational Lightness of trade marks: a legal perspective' in L Bently, J Davis, and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 224.

enable consumers to differentiate the product of one undertaking from those of other undertakings. This is the essence of preventing trade mark infringement.¹¹¹ Therefore, there should always be a clear link between the protection of the distinctive character of the mark and the products to which it is affixed. Otherwise, traders are likely to invest on the image or the advertising value of the mark which is cheaper and easier than investing and improving the quality of branded goods.

The question of quality under the dilution doctrine therefore goes beyond whether or not to enforce the quality function of the mark. Rather, it concerns the policy underpinning trade mark protection. As such, trade mark law should proactively seek to influence traders' commercial behaviour by not protecting and, thus, encouraging artificial product differentiation.¹¹² Building the distinctive character of the mark or its reputation on the mark itself rather than on the products to which it is attached might have a harmful impact on competition. It has been stated that:

The object of the law is to preserve for a trader the reputation he has made for himself, not to help him in the disposing of that reputation as of itself a marketable commodity, independent of his goodwill, to some other traders. If that were allowedly, the public would be misled.¹¹³

The idea of protecting the distinctiveness of the mark or its reputation *per se* face serious legal challenges particularly in the context of trade mark functions. In the following parts, we first explore whether the notion of expanding the protection of a reputable mark is related to the mark's role as a connection between a product and a certain level of quality. Second, by investigating the impact of a trade mark's reputation on consumer purchasing decisions, we highlight the risks in implementing Schechter's concept of protection on competition.

4.1 Schechter's Concept of Dilution: Legal Benchmarks

The notion of expanding the scope of protection for marks with a reputation is deeply rooted in the history of trade mark law. This type of protection however was and is directly linked to the mark's main role as a product identifier. If the mark is not to act as an anti-competitive tool, its selling power cannot be established in isolation from

¹¹¹ Directive 2008/95 to approximate the laws of the Member States relating to trade marks [2008] L299/25.

¹¹² See (n 7).

¹¹³ *Bowden Wire Ltd v Bowden Brake Co. Ltd* (1914) 31 RPC 385, at 392.

the products to which it is attached. This is not to suggest that marks with a reputation can only indicate the specifications of the branded goods. Rather, the suggestion here is that such expanded scope of protection should be implemented within the relationship of the mark with the products to which it is affixed and not in a vacuum. The Paris Convention, Article *6bis* refers to such a notion as does Article 16 of TRIPS and Article 5 (2) of Directive 2008/95. Article *6bis* of the Paris Convention clearly states that:

goods or services which are not similar to those in respect of which a trademark is registered, provided that use of that trademark in relation to those goods or services *would indicate a connection between those goods or services and the owner of the registered trademark* and provided that the interests of the owner of the registered trademark are likely to be damaged by such use (emphasis added).

Therefore, the expanded scope of protection for marks with a reputation in the case of dissimilar goods or services is directly related to their core role as a connector between particular goods or services and a specific brand. And once that connection has gone missing, such an expansive scope of protection cannot be legally justified.

The provision mentioned above is reflected and further enhanced in the Agreement on Trade-Related Aspects of Intellectual Property Law (TRIPS). Article 16 (3) reads:

Article *6bis* of the Paris Convention (1967) shall apply, *mutatis mutandis*, to goods or services which are not similar to those in respect of which a trademark is registered, provided that use of that trademark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered trademark and provided that the interests of the owner of the registered trademark are likely to be damaged by such use.

Similar provision is made under the First Trade Mark Directive where Article 5 (2) states:

... the proprietor shall be entitled to prevent all third parties not having his consent from using in the course of trade any sign which is identical with, or similar to, the trade mark *in relation to goods or services which are not similar to those for which the trade mark is registered, where the latter has a reputation in the Member State and where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark* (emphasis added).¹¹⁴

¹¹⁴ Directive 2008/95 (n 111); see also Article 9(1) (c) of Regulation 207/2009 [2009] OJ L 78/1.

Thus, a trade mark's selling power or reputation must not be built in a vacuum: it must always be attached to goods or services on which it is used and its protection should not go beyond or be separated from the goods on offer.

4.2 Relationship between the Selling Power of the Mark and the Purposes of Protection

One preoccupation of the courts in interpreting Article 5 (2) of Directive 2008/95 has been to establish the line for trade mark protection and whether it should go beyond the traditional boundaries of protection to include non-trade mark subject-matter and, if yes, why and to what extent. The ECJ has repeatedly upheld the fact that a trade mark reputation subtly reassures customers as to the quality of the branded goods or services.¹¹⁵ Thus, in order to justify the protection of the selling power of the mark, it is important not to lose sight of the fact that a trade mark needs to carry 'associated goodwill' in the minds of customers based on the experience or reputation of high-quality products and good service'.¹¹⁶ The essence of expanding the protection of marks with a reputation rests on the idea that consumers associate these marks with a high standard of quality. That is why even in case of dissimilar products or services, marks with a reputation still enjoy protection even in the absence of public confusion since such use would undermine that association and therefore the selling power of the mark. These previous facts are clearly reflected in the ECJ's case law.¹¹⁷

In its attempt to interpret the law and without restricting the trade mark functions, the ECJ made it clear that not all branding techniques stimulate competition. The ECJ pointed out repeatedly that 'undertakings must be able to attract and retain customers by the quality of their products or services, which is made possible only by distinctive signs allowing them to be identified'.¹¹⁸ The ECJ seems to be saying that if the objectives of the Directive are to be achieved, the concept of quality must be one of the keystones against which the goals of promoting competition can be measured. Protecting the selling power of the mark therefore is no more than a staging post on the road to differentiating the features and the quality of the products of one

¹¹⁵ *Intel Corp. Inc. v Sihra* [2003] ETMR 44; *Adam v Autech* (n 4).

¹¹⁶ *Haigh and Knowles* (39).

¹¹⁷ *Adidas v Marca Mode* (n 47) paras 40- 41; *Adidas-Salomon v Fitnessworld* (n 53) 31.

¹¹⁸ *Loendersloot v George Ballantine* (n 4); *Cnl-Sucal v Hag*, (n 4); *Bristol-Myer v Paranova* (n 4).

undertaking from those of other undertakings. Without this quality link, the selling power of the mark would enhance artificial product differentiation and, as a result, hinder competition and increase rather than decrease consumer searching costs.¹¹⁹

Once again, when considering the expansion of protection afforded to a mark with a reputation, one must consider the questions of how and where the selling power of the mark should be based. Building the selling power of the mark or its reputation on the mark rather than on the product upsets the balance between the gain and the costs of expanding trade mark protection. The act of protecting the distinctive character of the mark or its reputation *per se* enables the owner of the mark with a reputation to extend the monopoly power of the mark against other competitors. That is, an overall balance of potential costs and benefits of enabling the owner of the mark with a reputation to prevent the unauthorized collateral or derivative uses of the mark, should be considered in relation to the potential costs and benefits a third party would incur by being unable to make use of the mark.¹²⁰ These concerns are clearly acknowledged by the ECJ.¹²¹

Thus, there is not a case for expanding the rights of the mark owner against any perceived wrongdoing and therefore, to entitle him to prohibit the other's activities unless the economic benefits of this expansion exceeds the cost. The benefits of protecting the prestigious image of luxury goods might be insignificant in comparison with the restriction such protection might impose on competition. Instead, protecting a trade mark reputation should be understood as a way of deriving economic efficiency and enhancing consumer welfare by providing quality products rather than a way of protecting the owner of the mark with a reputation from the heat of competition. That is why Schechter's call for the protection of the distinctiveness of the mark to be 'the only rational basis' for trade mark protection, is questionable.¹²²

¹¹⁹ Chapter one, 28- 33.

¹²⁰ 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) 256.

¹²¹ *Adidas v Marca Mode* (n 47) 22; *Cnl-Sucal v Hag* (n 4); Case C- 100/02 *Gerolsteiner Brunnen v Putsch* [2004] ETMR 599, para 16; Case C- 228/03 *Gillette v LA-Laboratories* [2005] ETMR 825, para 29.

¹²² Schechter (n 2) 831.

There is a real risk of over-protecting a trade mark's selling power as a form of intangible output, equivalent to the subject-matter of a trade mark. Without paying regard to the question of quality, such an approach would inevitably jeopardise the objectives of the law and the Treaty since it fails to take account of the costs incurred through the expansion of protection. This can be clearly seen in the case of expanding the protection of the selling power of the mark in 'gross' since it is very difficult to envisage how such expansion of protection contributes to the objectives of the law.¹²³

It could be submitted that unless the resulting benefits of expanding the scope of protection for marks with a reputation outweigh the costs, there should be no case for expanding the protection beyond the necessary to ensure their effectiveness. The failure of trade mark law to show a consistent reflection in this delicate balance requires the rationale for trade mark protection to be reassessed and the boundaries to be re-rationalized. This can be done by re-affirming the indispensable role of the quality function in offsetting the anti-competitive aspects of trade mark protection.

In the next part, we will critically debate the notion of downgrading the interest of consumers under the dilution doctrine in favour of those of traders.

4.3 Where does Dilution Occur? New Grounds for Enforcing Quality

The need for paying regard to the quality function within the boundaries of dilution has to do not only with how the law and the Court of Justice interpret dilution but also with the question of where and how exactly dilution occurs. As already discussed, the focus under dilution is about the protection of the selling power of the mark and its brand value rather than on the consumer interest of not being confused. However, a close look as to how and where dilution occurs reveals that consumers occupy the centre stage and they have a role to play and, therefore, their interests should be taken into account.

Let us raise the following question: where does dilution occur? It takes place in a consumer's mind. Hence, the minds of consumers and how they perceive the mark is the benchmark against which the concept of dilution, as set up by Schechter, should

¹²³ Griffiths (n 120) 265- 266.

be measured.¹²⁴ Thus, dilution has been seen as a ‘psychological phenomenon’ that takes place in the minds of consumers.¹²⁵ The state of mind that needs to be checked, therefore, belongs to consumers and the way they perceive the relationship between the mark and the product to which it is attached: a sign of quality.¹²⁶ Hence, it might be true that preventing public confusion might not be an issue when establishing dilution. Nevertheless, any interpretation that does not take quality and, therefore, the way consumers perceive the selling power of the mark or its reputation into consideration might not be consistent with the law. It is difficult to envisage how promoting competition and the rhetoric of public interest would be achieved if the way consumers perceive the selling power of the mark is not taken into account when considering the level and scope of protection.

4.3.1 What gets Blurred or Tarnished?

The second question to be raised here is what exactly gets blurred or tarnished? Is it the reputation of the mark, its character or the perception of consumers as to the link between the mark and the products and services? The answer is clear: what gets blurred or tarnished is the perception consumers associate with the mark.¹²⁷ And this is how the essence of expanding protection for marks with a reputation should be understood. Accordingly, it could be submitted that all aspects of dilution, fame, distinctiveness, blurring, associations, tarnishment and harm to reputation are directly related to the mark and the products or services to which it is attached and the expansion of trade mark protection should always be viewed within that context.

4.3.2 Dilution and the Average Consumer: How Many Definitions are there?

When we say that dilution occurs in a consumer’s mind, what type of consumers do we mean and why? Interestingly, there is no consensus as to the mental standard or standards of this consumer. This can be due to the fact that there is no well-developed

¹²⁴ Schechter himself defined dilution as ‘the gradual whittling away or dispersion of the identity and hold upon the *public’s mind* of the mark or name by its use upon non-competing goods’. Schechter (n 2) 825.

¹²⁵ J Jacoby, ‘Considering the who, what, when, where and how of measuring dilution’ (2008) 24 Santa Clara Computer and High Tech L J 603.

¹²⁶ *Christian Dior v. Evora* (n 4); *Adam Opel v Autec* (n 4); *Cnl-Sucal v Hag* (n 4) and Case C- 9/93 *IHT Internationale Heiztechnik v Ideal-Standard* [1994] 3 CMLR 857.

¹²⁷ *Christian Dior v. Evora* (n 4); *Adam Opel v Autec* (n 4); see in general Schechter (n 2) 825; Jacoby (n 125).

theory of consumer sophistication.¹²⁸ It is difficult to predict or to think through the consumer and to see the market place as he sees it, the issue John Keats named ‘negative capability’.¹²⁹ That is why it seems that consumer interest rhetoric has double meanings. Indeed, the status of the consumer, his/her interest and most importantly how these interests can be protected under contemporary trade mark law is not comprehensible. One fact that is quite clear, however, is that the rationale of consumers’ interest is used as a vehicle to serve traders rather than to establish the objectives of the law. The way traders perceive consumers therefore depends, to a great extent, on how they perceive their own interests. Thus, the same consumer might be a ‘rational sovereign and a gullible fool’ as one commentator states:

The sovereign consumer...serves one master, namely, the trademark apologist, in theoretical disputes over the basis of trademark protection and another, the restrictionist, in disputes over the scope of that protection. The rational consumer may justify the protection of trademarks for their informational content, but, in his perspicacity, he also justifies a narrow scope of protection as against other similar marks. The consumer as fool is a similarly double-edged construct. *His susceptibility to the persuasive content of trademark undermines the basis of trademarks protection, but* this lack of discernment also recommends a wide scope of protection when protection is given. The result is that trademark apologists- and plaintiffs- tend to adduce the sovereign when they speak of the basis of protection and the fool when they speak of the scope. Trademark restrictionists- and defendants- do the reverse. They adduce the fool when they speak of the basis and the sovereign when they speak of the scope...These tensions...continue to muddle outcomes in the courts because

¹²⁸ B Beebe, ‘Search and Persuasion in Trademark Law’ (2005) 103 Mich L Rev 2020- 2025. The ECJ’s explanation of the metal standard of consumer is based on the orthodox view that a trade mark’s essential function is to identify the origin of good and services. Therefore, the consumer should be able to identify the origin of goods or services for which the trade mark is attached. That is why identifying how exactly the average consumer perceives the mark is very significant in terms on establishing confusion. Generally speaking, the average consumer perceives a sign as a whole and rarely has a chance to investigate its details. Case C- 251/95 *Sabel BV v Puma AG, and Rudolf Dassler Sport* [1998] 1 CMLR 445, paras 23-25. Thus, the average consumer is unlikely to compare the marks in issue a side-by-side. That is because; he deals with the infringing mark on the shop without having a chance to compare it with the original mark. K Schmidt, ‘Likelihood of Confusion in European Trademarks, Where Are We Now’ (2002) 24 EIPR 463- 465. The average consumer’s level of attention may vary depending on the goods and serves in issue. It should also be noted that not all consumers have the same level of accuracy or the same type of memory. Therefore, some groups of people, such as the elderly, might be more vulnerable to be confused than others; Phillips, (n 22) 23. As to the consumer’s level of attention, the Court pointed out that:

In order to determine whether a statement or description designed to promote sales... is liable to mislead the purchaser...the national court must take into account the presumed expectations which it evokes in an average consumer who is reasonably well-informed and reasonably observant and circumspect. Case C- 210/96 *Gut Springenheide GmbH, Rudolf Tusky v. Oberkreisdirektor des Kreises Steinfurt—Amt für Lebensmittelüberwachung* [1998] ECR I-4657, at 31.

¹²⁹ See generally D Markovits, ‘Legal Ethics From the Lawyers’ Point of View’ (2003) 15 Yale J L and Hum. 209- 272; G Austin, ‘Trademarks and the Burdened Imagination’ (2004) 69 Brooklyn L Rev 827.

trademark law lacks a well-developed theory of the consumer and, specifically, of consumer sophistication (emphasis added).¹³⁰

The aim of this discussion is to highlight the fact that the concept of protecting the selling power of the mark or its reputation as envisaged by Schechter should not be implemented without considering the interests of consumers as to quality issues. Hence, the argument that dilution is about the protection of the selling power of the mark is, therefore, not intended to protect the interests of consumers does not have much a chance of success when considered in the light of the objectives of the law and the economic grounds for achieving these objectives.

5. Dilution and Market Reality

In this part we ask the following question: what is the role of a trade mark reputation in expanding the monopoly power of a trade mark owner at the expense of his competitors? To this end, this part seeks to examine whether the current exploitation of the selling power of the mark, and, therefore, the concept of dilution, risks diverting the law from its course. As such, this part firstly seeks to investigate the increasing tendency of trade mark owners to separate the reputation of the mark from the products to which it is affixed. Secondly, it examines the extent to which a mark with a reputation has the ability to sell a product regardless of its specifications.¹³¹ Finally, this part investigates what did Schechter mean when he argued that protecting the distinctiveness of the mark is ‘the only rational basis’ for trade mark protection.¹³² If the mark with a reputation is capable of selling a product even with the availability of similar, yet cheaper substitutes, how does Schechter’s concept of protection fit with the law keeping in mind that marks are thought to enhance economic efficiency which means producing the best quality product for the lowest cost? These issues are addressed respectively.

5.1 Building a Reputation on a Brand not on the Product to which it is Attached

Traders seek to retain the loyalty of consumers using the most cost effective tool. Building a very strong reputation allows traders to maintain consumer loyalty

¹³⁰ Beebe (n 128).

¹³¹ See F Vanzetti, and R Marke, (1965) GRUR Int, 128- 134 cited in R Holzhauser, ‘Jenever and Jumping Wild Cats’ (2002) III The Economics of Intellectual Property 419.

¹³² Schechter (n 2) 831.

regardless of the product in question. Such worries have their grounds in today's marketing techniques. The increase of mass national and international marketing combined with the extensive reliance on advertising has enhanced the tendency towards a total separation between the mark with a reputation and the product on offer. Separating the reputation of the mark from the products it represents gains the owner of the mark greater flexibility to use the reputation of his mark on a wide range of products without giving consumers a reliable quality guarantee.

Traders are profit seekers. This fact must always be remembered. As such, they *only* use the quality function of a trade mark as a vehicle to retain the loyalty of consumers where there is no other more profitable and cheaper way to do so.¹³³ Put differently, there is a trade-off between the costs of 'saving from producing a lower-quality product with reduced marketing expenditure, set against the damage to reputation'. Traders therefore, build the reputation of their marks on the quality of their products only where maintaining quality is the cheapest available way of doing so. That is:

It is more accurate to describe the firm's self-interest as involving building a good reputation at least cost. Often the best way of achieving this combination *is through sophisticated marketing, rather than making a high-quality product*. Consumers come to believe the trade mark signals high quality, and may continue to do so even after purchase if the quality defects are hidden or debatable (emphasis added).¹³⁴

Building the selling power on the mark means that the mark has ceased its role as a product identifier since according to this scenario it will convey very little information as to the products quality, reliability and mode of manufacturing. An excellent example as to the restriction of the trade mark role as an indicator of a product specification or quality can be seen in case of associating a beer or a fizzy drink with a healthy, long lasting happy life. Another example can be seen in a different area such as parallel importation where two exactly identical products (two pair of jeans), one of which is allowed to bear the trade mark and the other is not because of the lack of the trade mark owner's consent.¹³⁵ Such branding technique can only work where it is possible to separate the mark from the product it represents. Put differently, such a

¹³³ See generally 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) 270.

¹³⁴ *Ibid*, 270- 271.

¹³⁵ *Id*, 271.

technique is likely where it is possible to build the reputation of the mark or its selling power on the mark itself rather than on the product to which it is attached.

Moreover, one of the key claims for justifying trade mark protection is that branded goods are ‘superior’ or ‘reassuring’ consumers’ willingness to pay a premium for branded goods.¹³⁶ Building the reputation of the mark in separation to the products to which it is affixed, jeopardizes the economic grounds for protection. This separation is true and real because it is widely known that the capacity of a mark with a reputation to acquire such status, particularly when it establishes itself in the market, depends ‘much less on the quality and conditions of the marked products than on its presentation and price’. This, in turn, transfers branded products ‘into symbols of status’ even though such status does not necessarily match any improvement in quality or other features.¹³⁷ This change in the performance of trade mark is best described by Naomi Klein. She states:

What was changing was the idea of what –in both advertising and branding – was being sold. The old paradigm had it that all marketing was selling a product. In the new model, however, the product always takes a back seat to the real product, brand, and the selling of the brand acquired an extra component that can only be described as spiritual.¹³⁸

This branding policy, separating the mark from the product to which it is attached, allows certain marks with a reputation to enjoy an absolute marketing and, therefore, competitive advantage over other competitors by building and enhancing the reputation of the mark rather than improving the quality of the product on offer. As Branson puts it:

We have never been constrained by the “what business are we in?” question’¹³⁹...The idea is to build ‘brands not around products but around reputation. The great Asian names imply quality, price and innovation rather than a specific item. I call these ‘attribute’ brands: they do not relate directly to

¹³⁶ Id.

¹³⁷ Griffiths (n 120) 253. Despite these facts, some neo-classical analysts argue that the capacity of marks with a reputation to attract consumers in such a way contributes to social welfare through reducing the ‘cost of satisfying a demand for social status’; see G Becker, and K Murphy, with E Glaeser, ‘Social Markets and the Escalation of Quality: The World of Veblen Revisited’ in G Becker, and K Murphy, (eds) *Social Economics: Market Behaviour in a Social Environment* (Mass: Belknap Press, Cambridge, 2000) 97, 98.

¹³⁸ Klein (n 154) 21.

¹³⁹ R Branson, ‘Virgin: The Virtues of a Diversified Brand’ in F Gilmore (ed.) *Brand Warriors: Corporate Leaders Share Their Winning Strategies* (HarperCollins Business, London 1999) 232.

one product- such as a Mars bar or a Coca-Cola- but instead to a set of values'.¹⁴⁰

Given the fact that limiting the impact of the trade mark monopoly can only be ensured by linking the protection of the mark to its fundamental function namely, indicating the differences between products, separating the reputation of the mark from the products to which it is attached inevitably jeopardizes the essence of trade mark protection by expanding the monopoly power of the trade mark owner where the mark enhances artificial product differentiation and the artificial partitioning of the market.

The persuasive power of the mark with a reputation combined with the separation between the mark and the products to which it is affixed marginalizes the essence of trade mark protection by unduly increasing the monopoly power of the mark. This, in turn, requires the scope of protecting marks with a reputation to be reconsidered. The fundamental purpose of trade mark protection is to promote competition and to reduce consumer searching costs which should always be the benchmarks against which the eligibility of the selling power of the mark for protection should be measured. Needless to say, as we have seen before, there is no way the mark with a reputation can enhance economic efficiency without conveying a clear and consistent quality message.¹⁴¹

The economic justification for trade mark protection is based on the idea that traders act in a competitive environment and they use trade marks to differentiate their products from those of their competitors.¹⁴² Marks allow traders to have a certain degree of monopolistic power which allows them to earn high profit. With that in mind and taking the idea of separating marks with reputation from the products to which they are attached, it is very difficult to envisage how trade marks can increase consumer welfare, let alone the impact such a strategy might have on competition. As already discussed, consumers perceive reputation, the selling power of the mark, as a strong quality indication. The elusive nature of this link, i.e. the link between the selling power of the mark and the quality function, creates inertia amongst consumers

¹⁴⁰ Klein (n 154) 24.

¹⁴¹ Chapter one, 28- 33.

¹⁴² Landes and Posner (n 4) 265- 309.

were usually stick with what they know. This, in turn, gives the owner of the mark great market power by creating a barrier to entry for newcomers.¹⁴³ Nonetheless, neither competition nor the public are beneficiaries of such a policy.

Again, as to the issue of expanding the boundaries of protection for the mark with reputation, it is important not to lose sight of the fact that this expansion can only be economically justified if it is proven that protecting intangible assets, such as a reputation, benefits society. A closer look at the concept of brand values reveals that they increase consumers' artificial wants. These artificial needs can be satisfied efficiently and by lower costs through 'marketing expenditure rather than improving the products themselves'.¹⁴⁴ This is not the end of the story since such a technique, satisfying social needs such as social status through branding, leaves more losers, those who can not afford to buy the products, than winners, who purchase the product.¹⁴⁵ Put differently, it is not healthy for social welfare and economic efficiency to simply stimulate new wants and then satisfy them since it is well-known that human 'happiness lies in narrowing the gap between what we have and what we want'.¹⁴⁶ If this argument is to be accepted however, then it must be proved that the mark with a reputation is capable of selling a product depending on the reputation of the mark rather than the quality of the product to which it is attached. This question is addressed next.

5.2 Can a Reputation Alone Sell a Product? A Practical Test

The argument against the protection of the selling power of the mark or its reputation as suggested by Schechter has its grounds in today's market reality.¹⁴⁷ Empirical studies show that marks with a reputation have a strong persuasive impact. This in turn means that the selling power of the mark can lure consumers into buying a product which is essentially the same as lower-priced alternatives. In this case, protecting the selling power of the mark or its reputation enhances artificial product

¹⁴³ Klein (n 154).

¹⁴⁴ Aldred (n 133) 274.

¹⁴⁵ Ibid.

¹⁴⁶ L Bruni, and L Stanca, 'Income Aspirations, Television and Happiness: Evidence from the World Values Survey' (2006) 59 *Kyklos* 205- 274.

¹⁴⁷ For more information see E Chamberlin, *The Theory of Monopolistic Competition* (Mass: Harvard University Press, Cambridge 1933); R Brown, 'Advertising and the Public Interest: Legal Protection of Trade Symbols' (1948) 57 *Yale L J* 1165, reprinted in (1999) 108 *Yale L J* 1619.

differentiation which is diametrically opposite to the objectives of the law.¹⁴⁸ This argument conflicts with the notion that trade marks are informative rather than manipulative tools.¹⁴⁹ In other words, reputable marks are not capable of selling products regardless of their qualities. This is despite the fact that the father of the dilution theory himself (Frank Schechter) pointed out that a positive trade mark reputation might not necessarily be the result of a good reputation for the quality and reliability of marked products but equally upon its ‘own uniqueness and singularity’.¹⁵⁰ A reputable mark does suggest, influence and persuade.¹⁵¹ In doing so, it deludes, and ‘induces consumer delusion as to needs and /or wants’.¹⁵²

Thus, it is quite plausible to assume that the uniqueness or individuality of a trade mark does influence consumers’ purchasing decisions and hence could enhance artificial product differentiation. As one observer states:

Our results show that meaningless differentiation is valued by consumers in a surprising number of situations. For example, meaningless differentiation is valued even if the differentiated brand is priced above all others and, more surprisingly, in some cases increasing price actually can increase preference for the differentiated brand. Furthermore, the competitive advantage created by adding an irrelevant attribute can be sustained even if consumers acknowledge the differentiating attribute is irrelevant.¹⁵³

Scott Bedbury, the vice president of marketing in Starbucks, clearly acknowledges that ‘consumers do not truly believe there is a huge difference between products’ and this is one of the reasons why brands must ‘establish emotional ties’.¹⁵⁴ It is not only the coffee that customers are after; they are after the ‘romance of the coffee experience, the feeling of warmth and community people get in Starbucks stores’.¹⁵⁵ Tibor Kalman observes that shift in the contemporary marketplace in this way: ‘the original notion of the brand was quality, but now brand is a stylistic badge of courage’.¹⁵⁶

¹⁴⁸ Chapter one, 28- 33.

¹⁴⁹ Landes and Posner (n 4) 274, 275.

¹⁵⁰ Schechter (n 2) 831.

¹⁵¹ Papandreou (n 1).

¹⁵² Beebe (n 128) 2043.

¹⁵³ G Carpenter et al., ‘Meaningful Brands From Meaningless Differentiation: The Dependence of Irrelevant Attributes’ (1994) 31 J Marketing Res 339.

¹⁵⁴ N Klein, *No Logo* (Harber Collins Publishing, London 2001) 20.

¹⁵⁵ H Shultz, *Pour Your Heart into it* (Hyperion, New York 1997) 5.

¹⁵⁶ T Kalman, ‘Variations: A Cover Story’ *New York Times Magazine* (13 December 1998).

5.3 Schechter's Notion of Trade Mark Protection: Risk Analysis

Schechter's notion of trade mark protection significantly increases the monopoly power of a trade mark owner at the expense of competition and consumers alike. For traders, Schechter's call for the protection of the distinctiveness of a trade mark does make perfect sense. It enables them to market their branded goods using the cheapest and most effective marketing tools. However, that notion of protection makes very little of the fact that unless the selling power, uniqueness or singularity of a mark are based on the quality or reliability of the product to which it is attached, the protection of its distinctiveness might distort competition and enhance artificial product differentiation thus artificial partitioning of markets. This is because apart from improving and maintaining the quality and reliability of a branded good, all other factors such as the singularity of a mark or its reputation, have very little economic substance.¹⁵⁷

Therefore, as a major tool in today's marketing strategies, there is a real risk of using the trade mark as a vehicle to mislead consumers rather than conveying information about the product on offer.¹⁵⁸ This risk becomes much more likely where firms try to work on their trade marks as assets in their own right and totally separated from the products to which they are affixed. It is widely agreed that:

The trademark is endowed with a sales appeal independent of the quality of price of the product to which it is attached; economically irrational elements are introduced into consumer choices; and the trademark owner is insulated from the normal pressures of price and quality competition.¹⁵⁹

The argument as to the soundness of granting protection to the selling power of the mark regardless of the way it has been built or used (in gross) is increasing. As one observer points out:

[S]ome advertising and associated trademarks serve as a form of blackmail. Such advertising seeks to persuade us by first creating or exacerbating our insecurities and self-doubts. It tells us that we are not pretty enough, not popular enough, not hip enough, not right enough. Only after it has shaken our self-image and disturbed our self-contentment does this type of advertising step forward to offer a remedy. Many consumers are susceptible to these ads and will take the remedy offered. This advertising can therefore persuade

¹⁵⁷ Chapter one, 28- 33.

¹⁵⁸ Aldred (n 133) 271.

¹⁵⁹ *Smith v. Chanel, Inc.*, 402 F.2d 562, 567 (9th Cir. 1968).

consumers to purchase a good they would not otherwise have bought or pay more for a good than they would otherwise have paid. This increased willingness to buy does not, however, reflect an aggregate increase in utility, and even if we limit our consideration to those consumers who are persuaded to purchase. In many cases, the consumer may pay the higher price simply to restore her pre-advertisement satisfaction level.¹⁶⁰

This argument highlights the fact that protecting the selling power of the mark or its reputation in gross should not be legally established without careful consideration of the legal and economic essence of this protection. Once again, emphasizing the importance of protecting the selling power of marks without emphasizing the direct link between the mark and the product creates artificial wants and artificial satisfaction as one commentator states:

It may well increase the total happiness in our society if every time a guy drinks a Budweiser or smokes a Camel, he believes he's a stud. We may all be better off if, each time a woman colors her hair with a L'Oreal product, she murmurs to herself "and I'm worth it". If that's so, however, Warner Brothers, Anheuser-Busch, R.J. Reynolds, and L'Oreal can hardly take all the credit. They built up all that mystique with their customers' money and active collaboration.¹⁶¹

Considering the present argument, two questions should be raised: how it is possible to separate the selling power of a mark or its reputation from the products to which it is attached? How are traders of branded goods capable of introducing economically irrational elements into consumer choice? To answer these questions, one first has to fully understand what psychologists and behavioral economists call the 'availability heuristic',¹⁶² and its impact on consumers' purchasing decisions and, secondly the role of neuromarketing on transferring consumers from quality bias to a brand bias. To this we shall turn our attention.

5.3.1 Market Power and the Concept of 'Availability Heuristic'

In this part, we examine the role of a trade mark reputation or singularity in expanding the monopoly power of a trade mark owner. To this end, we investigate how

¹⁶⁰ G Lunney Jr., 'Trademark Monopolies' (1999) 48 Emory L Rev 420.

¹⁶¹ J Litman, 'Breakfast with Batman: The Public Interest in the Advertising Age' (1999) 108 Yale L J 1730; see in general Brown (n 147) 1180- 1183.

¹⁶² D Kahneman, P Slovic, and A Tversky, (eds) *Judgment Under Uncertainty: Heuristics and Biases* (CUP, Cambridge 2002) 1- 19, 139; C Sunstein, *Laws of Fear: Beyond the Precautionary Principle* (CUP, Cambridge 2005) 13- 35.

consumers perceive the role of a trade mark reputation. This must lead us to what is termed ‘availability heuristic’. This concept is based on the assumption that people simplify complex situations by relying on rules-of-thumb when they make their decisions.¹⁶³ That is, people tend to ‘attach disproportionate weight to things that are “cognitively available” to them, such as things with which they are familiar or which they can readily call to mind’.¹⁶⁴ Thus, when a consumer wants to purchase a product, he usually attaches disproportionate weight to a mark with reputation as an indicator and reference point. This in turn means that the mark with a reputation is capable of acquiring or obtaining an excessive selling power, which is of great value to the owner of the mark. Acquiring such a powerful selling power nevertheless might have anti-competitive effects. This is because the sheer value it adds to the branded goods in comparison with how little it actually says¹⁶⁵ or actually adds to the product. A reputation gives a unique, yet false, impression of singularity and distinction by introducing economically irrational elements into consumer choice such as emotional ties. This allows the trade mark owner to excessively distort competition by retaining the loyalty of consumers without having to improve the quality of his goods. This cannot be legally or economically justified. This anti-competitive effect is not limited to the use of the mark or its reputation in relation to products related to the mark but also when the mark is attached to a different product. This can only be possible if the selling power of the mark or its reputation is based on the mark rather than on the products to which it is attached. That is one of the reasons why establishing a reputation seems appealing to traders.¹⁶⁶ Reputation says nothing and everything at the same time in a positive way, which enhances the value of the mark in question without having to go the hard way, improving the quality of the products on offer. Thus, objective facts that might affect a decision to engage with the offering are suppressed in favour of non-brand facts such as ideas that relate a brand to a certain

¹⁶³ See in general C Jolls, C Sunstein, R Thaler, ‘A Behavioral Approach to Law and Economics’ (1998) 50 *Stanford L Rev* 1471; D Kahneman, and S Frederick, ‘Representativeness Revisited: Attribute Substitution in Intuitive Judgment’ in T Gilovich, D Griffin, and D Kahneman, (eds) *Heuristics and Biases*. Gilovich *et al.* (CUP, Cambridge 2002) 49- 81.

¹⁶⁴ 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; Griffiths (n 120) 252.

¹⁶⁵ See in general D Vaver, ‘Brand culture: trade marks, marketing and consumption’- responding legally to Professor Schroeder’s paper’ in L Bently, J Davis, and J Ginsburg, (eds) *Trade Marks and Brands, an Interdisciplinary Critique* (CUP, Cambridge 2008) 177- 198.

¹⁶⁶ *Ibid*, 178,179; I Preston, *The tangled web they weave: truth, falsity and advertisers* (University of Wisconsin Press, Madison 1994) 89.

lifestyle or problem or motivation. So in that sense a computer is not only a computer, liquor doesn't just make you drunk. On the contrary, carrying a laptop makes you a man (if you are physically one otherwise you are not targeted by this brand) and, in the same way, liquor allows any nerd to be attractive to women.¹⁶⁷

In the same way, Pepsi's image as a fizzy drink is associated with youthfulness rather than with the fact that drinking lots of sugared water rots your teeth and increases the chance of obesity. In other words, you could do better by drinking tap water. A trader of fizzy drink would be very happy to convince a consumer with the idea that a fizzy drink is good as long as the consumer is happy to be convinced.¹⁶⁸ To avoid any fraudulent allegations, the trader may leave the image or reputation of its mark to speak for the product and thus encourage consumers to draw their own conclusions. In theory, it is the consumer who chooses to accept or reject the suggestion that he might be better off by swigging from a bottle of sugared water than from mineral water. In practice however, the reality cannot be further from the truth. Objectively, the relationship between Coca-Cola or Pepsi and concepts such as youthfulness has never existed. Still, the impact of the selling power of these formidable brands encourages consumers to think otherwise. As one observer points out as to the relationship between Pepsi and a healthy lifestyle:

The relationship does not exist physically. What I buy is a can or bottle of liquid containing certain ingredients-nothing more. I receive nothing from Pepsi that has any natural relationship to any characteristics of me. Nonetheless, I can see relationship if I want to. I am free, as is everyone, to decide in my own perception that Pepsi reflects my motivations or my psychological or social needs. If I say it does, then the relationship is true about me, not about Pepsi. And from that relationship I receive a value that I appreciate and enjoy- and might not receive from any other soft drink. These benefits are real in a very important way, not as physical realities, but as the realities of my own mind.¹⁶⁹

Such emotional or psychological attractions of certain trade marks to consumers can take several forms. This attraction can be perceived as to the ability of the mark to perpetuate an identity that acquires history or tradition; as Hays puts it: 'fifty-seven years later, she still recalled the taste of that Coke on that summer day...From then on, wherever she was, in a corner store or in a restaurant or on a place, she always

¹⁶⁷ Vaver (n 165) 177- 179.

¹⁶⁸ Ibid, 90.

¹⁶⁹ Id.

asked for Coca-Cola'.¹⁷⁰ The salient trade mark might also be used as a way of showing a certain social status such as wealth.¹⁷¹

The impact of brand values on the market power of the owner is profound. It simply allows the owner to relax his control over the quality and the conditions of the products on offer and at the same time it allows him to retain his exclusive right to authorize the use of his mark for marketing purpose. The economic role of marks with a reputation will be transformed from being a sign of origin and therefore giving consumers some information as to the specification and quality of products on offer, to being a link to a brand's value therefore conferring emotional or psychological attributes on the branded goods or services.¹⁷²

While it is clear that maintaining the quality of goods or services increases consumers' social welfare, it is far from clear how building the reputation of branded goods on the brand itself rather than on the product to which it is attached would improve social welfare. One fact, however, is very obvious: while there is a great tendency to expand trade mark protection beyond its traditional boundaries, from an economic point of view; it does not seem that there is a case for doing so.¹⁷³

One may argue that the appeal of marks with a reputation to consumers is normally founded upon the nature and quality of the products on offer and therefore it is difficult to sell a product of bad or low quality without being forced out of the market very soon. This argument is true, in particular, at the early stages of establishing the reputation of the mark as an indication of quality products. This reputation, however, can be easily developed through advertising and imagery and can therefore acquire an independent value and appeal to consumers regardless of the products which they have been used with.¹⁷⁴ As one observer states:

I doubt that many of you would welcome a commodity marketplace in which one competed solely on price, promotion and trade deals, all of which can

¹⁷⁰ C Hays, *Pop: Truth and Power at the Coca-Cola Company* (Arrow, London 2005) 8- 9.

¹⁷¹ L Bagwell, and B Bernheim, 'Veblen Effects in a Theory of Conspicuous Consumption' (1996) 86 *American E Rev* 349.

¹⁷² Drescher (n 20) 301.

¹⁷³ Griffiths (n 120) 255.

¹⁷⁴ *Ibid*, 252.

easily be duplicated by competition, leading to over- decreasing profits, decay and eventual bankruptcy.¹⁷⁵

In other words, instead of competing on the basis of real value, traders can compete on marketing and branding which does not add a lot to the quality of the product but is still relatively cheap and more importantly very effective in terms of easing competition. This *defacto* power should not be legitimized by legal protection. In principle, there is nothing wrong with the notion of expanding the scope of protection for reputable marks. However, the systematic degradation of the importance of enforcing quality under the dilution doctrine combined with the increased tendency to build the reputation of the mark on the brand rather than of the products to which it is attached undermines the legal and economic foundations of the law. Thus, unless it is economically proven that protecting the selling power of the mark or its reputation in gross stimulates competition and reduces consumer's searching costs, there should be no case for expanding the protection of marks with a reputation.

5.3.2 A Quality Bias or Brand Bias: the Impact of Neuromarketing?

In this part we investigate the impact of branding in transforming consumers from being a quality bias to become a brand bias. By now, it must have been clear that reputable marks influence consumers' purchasing decisions. The more the consumer purchases the product sold under the mark, the less vigilant he becomes about it. Reinforced by neuromarketing techniques, in many cases consumers develop a brand bias rather than a quality bias.¹⁷⁶ This means the consumer does not usually investigate the specifications of the product, particularly its quality, every time he buys the product. This mental or habitual relationship is enhanced by time and after while the buyer would not normally question the credibility of the mark unless the level of quality is reduced to the limit. Indeed, it is stated that:

Humans have a psychological momentum to continue doing the same thing in the same way as it was done in the past. Buying habits are no exception. There is comforting security in returning to a product...with which one is familiar.

¹⁷⁵ G Phillips, 'the U.S chairman of Ogilvy and Mather' cited in N Klein, *No Logo* (Harber Collins Publishing, London 2001) 14.

¹⁷⁶ C Yoon and others, 'A Functional Magnetic Resonance Imaging Study of Neural Dissociations between Brand and Person Judgments' (2006) 33 *The J of Consumer Research* 31.

Such a purchasing habit depends upon the tenacity of the past's hold upon the future.¹⁷⁷

Consumers perceive a reputable mark as a reliable and accurate indicator of quality regardless of whether it does truly convey this function or not. The loyalty of the consumer in this case relates to the mark itself not to the product to which it is attached. A survey conducted by the Henley Centre reveals that 'public trust brand names such as Kellogg's, Heinz and Marks and Spencer more than parliament, the police and the legal system'.¹⁷⁸ Such results indicate that marks are not impartial sources of information and they play a positive role in shaping consumers' purchasing habits. It is a revealing testimony on the impact of brand loyalty in affecting consumer purchasing decisions. Brand loyalty prevents consumers from choosing cheaper yet similar quality substitutes and also decreases the ability of buyers to spot variation in quality. In this case, the mark becomes an anti-competitive tool as it allows the owner of the mark to have a disproportionate level of monopoly which cannot be legally justified. This is because the monopoly power of the mark in that case does not contribute to the process of competition; neither does it enhance consumers' welfare.

A 'neuroeconomists' behavioural research provides that consuming or purchasing a product sold under a favoured brand creates an emotional reaction in a buyer's brain (a pleasant feeling of satisfaction).¹⁷⁹ Such positive reaction affects the ability of the consumer to switch to a different product and in some cases it negatively influences his ability to spot variation in quality. Neuroscientists use nuclear magnetic resonance imaging to investigate a person's decision-making process and his estimation of drawbacks and advantages during this process, especially in the field of commerce when buying a product or trading. With this technique the participant's brain activity is recorded and active brain areas are identified during simulated trading

¹⁷⁷ J McCarthy, *Trade Marks and Unfair Competition* (2nd edn, Rochester 1984) cited in L akazaki, 'Source Theory and Guarantee Theory in Anglo-American Trade Mark Policy: A Critical Legal Study' (1990) 72 J of Patent and Trade Mark Office Society 255.

¹⁷⁸ Sunday Times, 'A can of worms is a bad diet' 5 April 1998.

¹⁷⁹ Hollricher, 'Die Marke macht's' (2005) *bild der wissenschaft* 24- 28; see also H Rosler, 'Anti-Counterfeiting in Online Auctions from the Perspective of Consumer's Interests' (2006) 37 IIC 771, 888; for general information see P Glimcher, *Decisions, Uncertainty, and the Brain: The Science of Neuroeconomics* (MIT Press, Cambridge 2003) 169.

situations. This area of research is called ‘Neuroeconomy’.¹⁸⁰ A subdivision of this area is Neuromarketing,¹⁸¹ which specifically covers the investigation of factors that influence the decision to buy a product or not. The impact of a brand image on a customer’s decision is investigated and how a brand can be created by appropriate advertisement.¹⁸²

Current theories assume that a human is entirely rational in his decision-making process and generally acts egoistically, thus only seeking his own advantage. It is stated that a person only behaves altruistically, when he sees a gain in helping someone. However, recent research suggests that this is not always the case and people do act altruistically without a personal benefit. It was shown that emotions play a major in this process. Trust is generally rewarded by people’s behaviour, whereas mistrust and cheating is punished. By scanning a person’s brain certain areas have been identified to be important for the build-up of trust, which is close to the human rewarding system.¹⁸³

Traders (companies) would like to find out how trust in their products can be created efficiently. Research work undertaken by a group at the University of Munich suggests that when dealing with a favourite brand a person’s brain shows activity is similar patterns to the ones connected to trust and positive emotions.¹⁸⁴ The previous research reveals interesting results. In an experiment to assess the impact of a mark with a reputation, such as Coca-Cola, testers were told that one of the classes contains Coca-Cola; most of them preferred this one despite the fact that the glass in concern contained Pepsi Cola. In blind experiment however the mainstream prefers Pepsi Cola.¹⁸⁵ In another blind testing experiment, consumers have encountered difficulties identifying their preferred beer brand.¹⁸⁶

¹⁸⁰ Hollricher (n 180).

¹⁸¹ Ibid; Neuromarketing is simply techniques seek to highlight how consumers make their purchasing choices. Researchers map the test parson’s brain to assess how it reacts to a particular advertisement or a product. The concluded results can be implemented via branding and adverting techniques.

¹⁸² Id.

¹⁸³ Id.

¹⁸⁴ Id.

¹⁸⁵ V Packard, *The Hidden Persuaders*, (Ig Publishing, New York 2007) 45; see also Rosler (n 180) 781.

¹⁸⁶ Packard (n 185).

6. Overview

Trade mark law should protect and preserve a trade mark reputation as a sign of quality. Apart from this context, the law should not treat reputation as a marketable commodity and thus a protectable subject-matter independent of the product to which it is attached. The debate about the wisdom of protecting the selling power of the mark in gross should perhaps be conducted with candid reference to broader economic and legal policies rather than under the cover of enhanced protection of goodwill as suggested by Schechter. The selling power of a mark or its reputation must not be allowed to be used by a trade mark owner to hammer any potential competition or to enhance consumer's irrational behaviour.

The preceding three chapters have sought to highlight the potential impact of failing to enforce the quality function under trade mark law with the main emphasis on the risk of expanding the monopoly power of the trade mark, enhancing artificial product differentiation and the artificial partitioning of the markets between Member States. The next part will critically examine why the quality guarantee is not enforced under trade mark law. This part of the thesis has two chapters. The first explains and critically reassesses the notion that the quality guarantee is an economic function that trade mark law does not have to bother itself with. The goal is to identify when and how the current legal framework on trade marks generates problems in the domain of quality. This chapter is particularly important. It explains why market forces alone cannot be trusted to enforce the traders of branded goods to maintain a consistent quality, thus generating the need to regulate this function under the boundaries of trade mark law.

The second chapter investigates when and how the current legal framework could not rectify any unfairness uncovered- thinking, for example, of the extensive protection offered by consumer protection regulations, Sale of Goods Act and trading standards regimes. This chapter investigates the concept of quality under consumer protection law. It highlights the fact that the rationales for regulating quality under consumer law are not the same under trade mark law; thus the former should not be used as an excuse for failing to regulate the quality function of the mark under trade mark law.

Chapter Four: Rethinking Deregulation: The Enforcement of the Quality Function under the Chicago Economic School Revisited

1. Introduction

In this chapter, we ask a question: if the quality guarantee is important for the achievement of the legal and economic objectives of trade mark protection, why then is it not enforceable under trade mark law? A ‘law and economics’ approach or what might be loosely termed ‘Chicago economics’ is used to explain the development of trade mark law and, at the same time, to examine how the law can efficiently achieve its objectives. As we have already seen in chapter one, two of the chief proponents of this approach, Landes and Posner, argue that trade mark protection has an underlying economic logic that seeks to achieve economic efficiency.¹ The Chicago School uses economics to ‘explain the structure of trademark law rather than to change the law’. They add ‘our overall conclusion is that trademark law, like tort law in general... can best be explained on the hypothesis that the law is trying to promote economic efficiency’.² The use of law and economics therefore is based on the notion that the right to trade mark protection is to achieve economic efficiency and to maximise social welfare.

The Chicago law and economics approach has profoundly influenced the development of trade mark law in general and the enforcement of the quality function in particular. According to Chicago economists, traders are unable to lower the quality of their branded goods without risking the loss of business; a matter closely related to the presumption that as traders have obvious economic interests to maintain the quality of their branded goods there is no need to enforce the quality guarantee by law.³ As such, consumers will reward firms with a reputation and thus maintain consistent

¹ Chapter one, 14- 22; for general information see I Png, and D Reltman, ‘Why are some products branded and others not?’ (1995) 38 J L and Economics 207- 224; B Klein, and K Leffler, ‘The Role of Market Forces in Assuring Contractual Performance’ (1981) 89 J Political Economy 615- 641; P Nelson, ‘Information and Consumer Behaviour’ (1970) 78 J Political Economy 311; P Dixon, and C Greenhalgh, ‘The Economics of Intellectual Property: A Review to Identify Themes for Future Research’ (2002) Oxford Intellectual Property Research Centre 1- 64.

² W Landes, and R Posner, ‘Trade Mark Law: An Economic Perspective’ (1987) 30 J L and Economics 265.

³ Ibid, 269- 271; R Posner, *Economic Analysis of Law* (7th edn, Aspen Publishers, New York 2007) 370.

quality levels with repeat purchases and punish those with a bad reputation by not buying their products. This incentive is termed by Landes and Posner as the ‘self-enforcing feature’ of a trade mark.⁴

Despite its surface appeal, on deeper scrutiny, the Chicago approach suffers from internal inconsistency and practical difficulties. The controversy rests on the idea of using a cluster of assumptions which are not particularly popular between economists. The Chicago law and economics movement assumes that consumers are self-interested (rational) in a narrow sense and they always seek to maximize their own personal material benefits.⁵ Chicago economists in general and, Posner in particular, rely on traditional law and economics which suggests that consumers make their purchasing decisions based on their anticipation of the expected outcomes of their decisions.⁶ Under this view, consumers are seen as rational players able to estimate the likely outcomes of uncertain decisions and to select the outcome which maximises their welfare at the time the decision is made. This is because markets work well in supplying consumers with product information and consumers, who are assumed rational, would make the correct purchasing decisions.⁷ In turn, this assumed rationality means that consumers should be held accountable for their purchasing decisions. That is why Chicago School does not pass judgement on a consumer’s preferences or purchasing decisions even if they appear to be irrational, immoral or in some cases economically suicidal.⁸ The key benefit of such an approach (consumer sovereignty or freedom to choose) is not ‘welfare maximization of any sort, but rather the simple tolerance of the desires of others’⁹... the ultimate goal, in other words, is

⁴ Landes and Posner (n 2) 270.

⁵ M Friedman, *Capitalism and Freedom* (The University of Chicago Press, Chicago 2002) 13- 16; the Chicago concept of wealth maximisation gave rise to a flurry of criticisms. Examples include, T Kronman, ‘The Value of Moral Philosophy’ (1998) 111 *Harvard L Rev* 1751; J Coleman, ‘Efficiency, Utility, and Wealth Maximisation’ (1980) 8 *Hofstra L Rev* 509; R Dworkin, ‘Is Wealth a Value?’ (1980) 9 *J L S* 191; 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) 267- 270; T Kronman, ‘Wealth Maximisation as a Normative Principle’ (1980) 9 *J L S* 227; E Weinrib, ‘Utilitarianism, Economic, and Legal Theory’ (1980) 30 *U Toronto L J* 307.

⁶ Posner (n 3); Landes and Posner (n 2) 269- 271.

⁷ Landes and Posner (n 2) 269- 271.

⁸ B Beebe, ‘Search and Persuasion in Trademark Law’ (2005) 103 *Michigan L Rev* 2058; G Romp, *Game Theory: Introduction and Applications* (OUP, Oxford 1997) 1- 4.

⁹ J Persky, ‘Consumer Sovereignty’ (1993) 7 *J Econ PERSP* 183- 189.

liberty, not efficiency; the latter is merely a felicitous incident of the pursuit of the former'.¹⁰

The notion that market forces are sufficient to protect the interest of consumers as to quality issue, or the so-called 'self-enforcing feature' of a trade mark, is based on a game-theory analysis. Game theory is applicable in countless scenarios where almost any situation can be animated as a game.¹¹ This theory is used to predict the outcome of lawmaking using information about the preferences of players (individuals).¹²

The problem, however, is that it is difficult to obtain reliable observations of trader or consumer behaviour under game theory analysis. As this chapter will demonstrate in detail, the elements that influence a trader's decision to maintain the quality of his/her branded goods are enormously complex, unpredictable and uncertain, often because the rationale of maintaining consistent quality is related to two distinctive factors: the dynamic nature of markets and how a trader sees the reputation of a mark as purely an investment tool, in comparison with the way a consumer perceives it- a sign that, among many other things, indicates the origin or quality of a product. For a consumer, therefore, a trade mark can be much more than an economic tool. As such, his relationship with the mark is not limited to its economic functions. Thus, the notion of the rational consumer, assumed by Chicago economists, becomes unrealistic and, in some cases, even inaccurate. Ultimately, it will be argued that trade marks may indeed indicate a certain level of quality but they do not necessarily maintain consistency of quality.¹³

In this chapter, our discussion will begin by examining first the mechanisms of which the well-being of a society can be measured and then the most popular approaches to achieve that goal (enhancing the well-being of the society). As such, parts 2 and 3 will focus on what goal (s) the law should promote and more importantly how. The

¹⁰ Beebe (n 8).

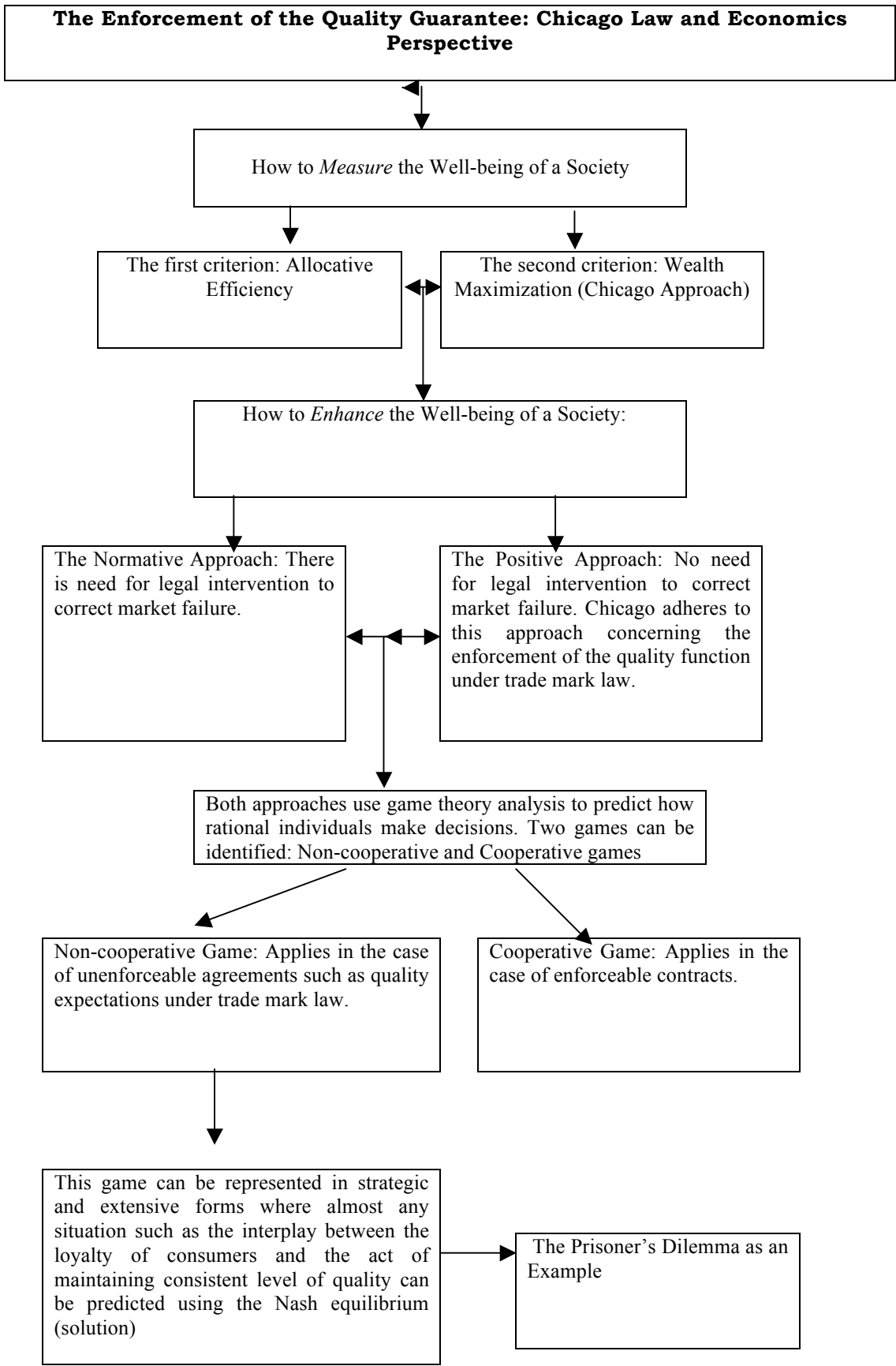
¹¹ J Morrow, *Game Theory for Political Scientists* (Princeton University Press, Princeton 1994) 1- 2; T Siegfried, *A Beautiful Math: John Nash, Game Theory, and the Modern Quest for a Code of Nature* (Joseph Henry Press, Washington 2006) 51.

¹² D Law, 'Introduction: Positive Political Theory and the Law' (2006) 15 *Journal of Contemporary Legal Issues* 1- 4; D Smith, J Banks, *Positive Political Theory I: Collective Preference* (Michigan University Press, Michigan 1999) 1- 25.

¹³ See in general Aldred (n 5) 270.

chapter goes on to investigate the use of game theoretic analysis in law where the act of policymaking is treated as a strategic game. As such, the conducts of individuals can be predicted. By examining the notion that individuals are rational and they always seek to maximise their wealth, part 5 of this chapter will investigate whether market forces are sufficient to enforce traders to maintain the quality of their branded goods.

As a lawyer, I shall not attempt to analyze the richness of meaning captured by generations of economic interpretation. This is not the place to describe the distinctive features of law and economic movement in general, or the Chicago School in particular, in detail. Instead, I persist in asking: why this, the quality guarantee, is not legally enforceable under trade mark law? To this end, only issues that are directly related to this question will be addressed. The link between law and economic movement and game theory, on the one hand, and the enforcement of the quality function, on the other, might not be easy to spot. Thus, to simplify the debate, the following diagram provides a graphic overview as to how these three issues are related. The diagram particularly highlights, in particular, the role of game theory analysis in identifying the preferences of individuals (consumers) who do not have actual information about the behavior of other players (traders). This constitutes market failure. The ultimate goal of utilising game theory analysis is to establish whether or not law intervention is necessary to address that market failure.



2. How to Measure the Well-being of a Society?

The conventional view is that the economic well-being of a society depends on achieving a workable competitive market economy. But what are the criteria against which the concept of economic well-being can be measured? Put differently, what should a legal system try to maximize?

2.1 Allocative Efficiency

The first criterion of social welfare is largely attributed to the Italian economist Vilfredo Pareto.¹⁴ Pareto developed the notion of allocation efficiency, best known as ‘Pareto optimality’. Under this approach, the well-being of a society is measured in terms of how effectively the allocation of resources satisfies the economic wants and desires of individuals in society and thus generates the highest possible level of social well-being throughout the community as a whole.¹⁵ Under this concept of competitiveness, economic resources are allocated between different goods and services in such a way that it is not possible to make anyone better off without making someone else worse off.¹⁶ At this stage, one attains a Pareto efficient allocation of resources, otherwise, market failure is deemed to have occurred.

2.2 Wealth Maximization

By contrast, Posner and some other Chicago economists adhere to Kaldor-Hicks paradigm of wealth maximization.¹⁷ Under this concept of economic well-being, any change within an economy that favours some individuals at the expense of others will constitute an improvement, if the gains to the winners exceed the losses to the losers.¹⁸ Posner advocates for the use of wealth maximisation as a guide to judicial action. The previous concept combines:

¹⁴ Coleman (n 5) 512.

¹⁵ Dworkin (n 5) 139.

¹⁶ R Whish, *Competition Law* (5th edn, LexisNexis, London 2003) 1- 4; G Dutfield, and U Suthersanen, *Global Intellectual Property Law* (Edward Elgar, Cheltenham 2008) 49.

¹⁷ Coleman, (n 5) 513. For Posner, wealth maximisation is a mechanism to evaluate the consequence of changing legal rules. The author would like to thank Professor Andrew Scott for his comments on this issue.

¹⁸ N Mercuro, and S Medema, *Economics and the Law: From Posner to Post-Modernism* (2nd edn, Princeton University Press, Princeton 2006) 48. In the course of defending the notion of wealth maximisation, Posner defines the term wealth as value. This value is measured by ‘what people are willing to pay for something or, if they already own it, what they demand in money to give it up’. For

...elements of utilitarianism and individualism and in so doing comes closer to being a consensus political philosophy in our contentiously pluralistic society than any other overarching political principle. This point is concealed by the fact that the term “wealth maximisation” is not a term in common usage. It would be easy to show, however, that many invocation of fairness and justice, “balancing” and due process and other familiar principles or methods of judicial decision –making are proxies for wealth maximisation.¹⁹

This economic notion of well-being has generated a great deal of criticism. Coleman, for instance, dismisses Posner’s concept of efficiency stating that wealth maximisation is neither more defensible than utilitarianism nor it is an alternative efficiency criterion. In fact it is not an efficiency criterion at all.²⁰ Similar remarks were made by Dworkin who passionately criticised Posner’s notion of efficiency. Dworkin questions whether wealth maximisation is a worthy goal so that judicial decisions should try to maximise pointing out:

Who would think that a society that has more wealth, as defined, is either better or better off than a society that has less, except someone who made the mistake of personifying society, and therefore thought that a society is better off with more wealth in just the way any individual is?²¹

Dworkin adds, in some cases a gain in social wealth may be outweighed by losses in utility or fairness. Thus, a gain in social wealth ‘considered just in itself, and apart from its costs or other good or bad consequences, is no gain at all’. Further, Posner argues that in a society dedicated to wealth maximisation, people can improve their position only by benefiting others.²² This argument however does not ‘specify the metric it assumes for testing whether a society bent on wealth produces more beneficial-for-others activity than a society that encourages a more direct altruism’.²³ It is not clear that more ‘wealth will be produced by people for other people, as distinct from themselves, under wealth maximisation than under a system of taxation and redistribution , even though the latter produced less wealth altogether’.²⁴ Dworkin

economists however, wealth does not necessarily mean money. He concluded that the morality of wealth maximisation resembles what a student of Adam Smith called ‘capitalist conception of justice’; R Posner, ‘Utilitarianism, Economics, and Legal Theory’ (1979) 8 JLS 119- 130, 135; see also R Posner, ‘Wealth Maximisation Revisited’ (1985) 2 Notre Dame J L, Ethics & Public Policy 85.

¹⁹ Posner (n 18) 104.

²⁰ Coleman (n 5) 521.

²¹ Dworkin (n 5) 194.

²² Posner seems to adhere to Friedman’s concept of rationality and wealth maximization; Friedman (n 5).

²³ Dworkin (n 5) 211.

²⁴ Ibid.

also describes Posner's claim that individuals seeking wealth only for themselves will produce a distributive justice better than a society not single-mindedly pursuing that goal without adequate specifications, as 'merely tautology'.²⁵

The law and economics movement, especially the Chicago law and economics, has been criticized on the ground that rational choice theory in economics makes unrealistic simplifying assumptions. The Chicago School models are based on perfect rather than workable competition. According to the Harvard sociologist Daniel Bell, this love of an idealised system is the defining quality of radical free market economics. Capitalism is envisaged as 'a jewelled set of movements or a celestial clockwork... a work of art, so compelling that one thinks of the celebrate pictures of Apelles who painted a cluster on grapes so realistic that the birds would come and pick at them'.²⁶ Given the overriding need to pursue justice and fairness in distribution through the legal system, many scholars believe that that deregulation approach, and thus efficiency, as defined by the Chicago School, could 'never be the ultimate end of a legal system'.²⁷

3. Schools and Perspectives in Law and Economics

After examining the criteria against which the well-being of a society can be measured, in this part we investigate *how* the well-being of a society can be enhanced. Economic analysis of law is usually divided into two subfields, positive and normative.²⁸ To this we shall now turn.

3.1 The Positive Approach

This approach uses economic analysis to predict the effects of various legal rules. According to Posner, this approach helps explain and predict how various laws will affect the behaviour of individuals.²⁹ It might determine that a certain sanction is more likely to deter a certain crime. This analysis however does not mean that the law

²⁵ Ibid, 212.

²⁶ D Bell, 'Models and Reality in Economic Discourse' in D Bell, and I Kristol, (eds) *The Crisis in Economic Theory* (Basic Books, New York 1981) 57- 58.

²⁷ F Parisi, 'Positive, Normative and Functional Schools in Law and Economics' (2004) 18 Eur J L and Economics 259- 272.

²⁸ Mercurio and Medema (n 18) 45.

²⁹ Coleman (n 5) 549.

should be adopted to correct market failure.³⁰ This is because Chicago economists rely on the standard economic assumption that individuals are rational wealth maximisers.³¹ Friedman argued that individuals are effectively free to enter or not to enter into any particular exchange ‘so that every transaction is strictly voluntary’. As such, no exchange will take place unless all parties do benefit from it.³² Cooperation is ‘thereby achieved without coercion’. In this context, the ‘consumer is protected from coercion by the seller because of the presence of other sellers with whom he can deal’.³³ In the same way, the seller is protected from coercion by the consumer because of other consumers to whom he can sell. In this case, individuals co-operate with others because, by doing so, they satisfy their own wants effectively.³⁴ As such, individuals (and entities) study the role of law as a means for changing the relative prices attached to alternative individual actions. Under this view, a change in the law will affect human behaviour by altering the relative price structure.³⁵

The positive political theory treats policymaking as a game of strategy and focuses on the choices that rational actors make in pursuit of their goals. According to this approach, law is a form of policy. As such, law making can be modelled as a game of strategy in which ordinary individuals (assumed as rational actors) seek to maximise their material interests.³⁶ The essence of this approach is to explain and predict the content of the law and the course of its development. To this end, game theory is used to derive predictions about the outcome of the lawmaking form information about the preferences of the players (individuals).³⁷ As discussed in chapter one, this positive theorizing approach has been dominant in the field of property rights, in particular concerning the enforcement of the quality function under trade mark law.³⁸ By relying on this particular approach to economics, the Chicago law and economics movement has concluded that the proprietor of a trade mark has an economic interest not to allow the quality of the goods sold under his banner to decline, which obviates

³⁰ Ibid, 549.

³¹ Friedman (n 5).

³² Ibid. Some of Milton’s ideas raised serious ethical concerns where he, for instance, argued that commercial entities should not have social responsibility whatsoever. As such, donating money for charity is an ‘inappropriate use of corporate funds in a free-enterprise society’. Ibid, 133- 135.

³³ Ibid, 13- 16.

³⁴ Id.

³⁵ Parisi (n 27).

³⁶ Law (n 12); Smith and Banks (n 12).

³⁷ Ibid.

³⁸ See chapter one, 13; see also Mercurio and Medema (n 18) 245.

the need for legal enforcement. This point will be further developed in this chapter (section 5).

3.2 The Normative Approach

The normative law and economics often goes one step further and makes policy recommendations based on the economic consequences of various policies. According to this approach, it is believed that there is a larger need for legal intervention in order to correct for pervasive forms of market failure. Legal intervention therefore is believed to be the appropriate way of correcting such failures.³⁹ Under this approach, efficiency is seen as a goal both of ‘current social policy and judicial behaviour and argues that governments should intervene in human affairs or rearrange socio-political and legal institutions to promote efficiency’.⁴⁰

4. Game Theory of Economics

One important development on the law and economic movements has been the application of game theory to legal problems. Under this theory, policymaking is treated as a game of strategy. As such, the focus is on the choices that rational actors make in pursuit of their goals.⁴¹

4.1 What is Game Theory?

In order to understand social situations, we need a theory that explains how individual’s decisions are interrelated. Game theory is one such theory. The theory applies where there is imperfect information that is where a player has to rely on his/her ‘rational’ expectations of the behaviour of the other simply because he/she does not have *actual* information about the behaviour of the other player. As such, game theory analysis is concerned with how rational individuals make decisions when they are mutually interdependent.⁴² Put differently, the game theory analyses situations in which strategic uncertainty is present. The latter occurs when the outcome of an action does not only depend on one player’s act but on one more

³⁹ Parisi (n 27).

⁴⁰ Coleman (n 5) 549.

⁴¹ Law (n 12); Smith and Banks (n 12).

⁴² M Osborne, *An Introduction to Game Theory* (OUP, Oxford 2004) 1- 4.

actor.⁴³ Players can be individuals or collective entities that make consistent choices. In order for the game to work, a player must play rationally.⁴⁴ As such, the theory can be used as an analytical tool to predict and also to explain and prescribe.⁴⁵ Under this theory, two distinguished branches can be identified: the Co-operative⁴⁶ and Non-cooperative game. The former applies in the case of enforceable contracts. The latter applies in the case of unenforceable contracts between players. Examples include the relationship between the traders of branded goods and their customers where the expectations of consumers regarding the quality of goods are not legally enforceable under trader mark law. Another example could be competition between economic agents in the market. In this regard, the Non-cooperative game theory is a framework that treats strategic settings as games where the outcome of one individual's optimal behaviour depends on what he or she believes the other will do. In this chapter, our analysis will be restricted exclusively to that game, the Non-cooperative game.

According to game theory, *individualism* is very important. In the Non-cooperative game, as just mentioned, players (individuals) are unable to enter into binding and enforceable agreements with one another. This assumption however does not mean that individuals do not work together. They do work together not because they have to but because it is in their own interest to do so.⁴⁷ Another assumption under the game theory is that individuals are *rational* hence it is assumed that they will act in their own self-interest. This means that individuals are able to determine the outcome of their actions.⁴⁸

The problem however is that considering the complexity of many decisions and the amount of information required to analysis many situations rationally, the rationality assumption seems unrealistic. Given the long-run equilibrium of the economy, it is possible to identify rational firms through the outcome of competition where irrational players eventually will be forced to leave the market.⁴⁹ When it comes to consumers

⁴³ K Binmore, *Game Theory: A Very Short Introduction* (OUP, Oxford 2007) 2.

⁴⁴ Ibid.

⁴⁵ C Camerer, *Behavioral Game Theory: Experiments in Strategic Interaction* (Princeton University Press, New Jersey 2003) 5.

⁴⁶ This theory focuses on how individuals committed to each other formulate rational decisions. Romp (n 8) 2.

⁴⁷ Ibid, 1- 5.

⁴⁸ Id; J Watson, *Strategy: An Introduction to Game Theory* (Norton & Company, London 2002) 79.

⁴⁹ Romp (n 8) 3.

however, the same is not true. There is no evolutionary process where rational consumer can eliminate non-rational consumers. The lack of such a process means that the economy will not necessarily converge on the rational outcome.⁵⁰ Finally, the concept of rationality adhered to by Chicago School does not explain how exactly individuals make a complex decision. Rather, it simply assumes that they will act rationally.⁵¹

In order to identify the motivation of players in a game, economists have invented the term utility. This allows each player to assign a numerical value to each possible outcome of a game. The theory however does not assume that some preferences or outcomes are more rationales than others. It simply regards reason as an instrument for avoiding inconsistent behaviour. As such, all consistent behaviours count as rational.⁵² According to the theory, acting consistently is assumed as seeking to maximise the value of something (utility). So in order to predict an individual's behaviour, we have to measure his utility or preference. But first we need to measure how much value the tested individual is prepared to assign to any preference.⁵³ To this end, we need to establish a criterion or scale to use. For this purpose, we pick two outcomes that are respectively better and worse than any other outcome the tested individual is likely to encounter.⁵⁴

4.2 John Nash Equilibrium and Game Theory

John Nash initiated the modern theory of rational bargaining where he established the so called Nash equilibrium (solution). This is now considered as the basic building block of the theory of games.⁵⁵ As noted, it is assumed that rational players seek to maximise their payoff. However, this is not easy given the fact that players do not know what strategies their opponents were going to choose. A Nash equilibrium is a pair of strategies whose use results in a cell in which both payoffs are identified. A Nash 'solution' only occurs when all players are making the best reply to the strategy

⁵⁰ Ibid; for a critique of game theory see A Kelly, *Decision Making Using Game Theory: An Introduction for Managers* (CUP, Cambridge 2003) 173.

⁵¹ Romp (n 8) 3.

⁵² Binmore (n 43) 7.

⁵³ Ibid, 8.

⁵⁴ Id.

⁵⁵ Ibid, 12.

choices of the others.⁵⁶ According to Nash, rational players use reason to solve a game. Individuals learn from experience. For each game, Nash proposes a solution, which should be a reasonable prediction of *rational behaviour* by players.⁵⁷

4.3 Strategic versus Extensive Game

There are two ways of representing a non-cooperative game: the strategic and the extensive form. We restrict our analysis to the strategic form. This game lists each player's strategies, and the outcomes that result from each possible combination of choices.⁵⁸ Under a non-cooperative game, the consumer (assumed to be a rational individual) is engaged in a game with the producer. The problem however is that the trader (producer) will have full knowledge of the quality of the product regardless of the trade mark. By contrast, the consumer has only limited knowledge. As we will next see in the prisoner's dilemma, how best to respond to asymmetric information of this type can, in certain contexts, be solved by using the Nash equilibrium (solution). Nash's solution identifies the situation where all players have chosen their moves and they have no incentive to change because any change would make them worse off.⁵⁹

4.3.1 The Prisoner's Dilemma as an Example

In the Prisoner's Dilemma, every player chooses the course of action that is most advantageous to them. What is the best action will depend on the other player's choices. That is why, when a player chooses an action, he must bear in mind the options available to other players. In other words, he must take a view about the other player's likely actions.⁶⁰ But how exactly can a player take such a view? The assumption is that each player's belief is derived from his past experience playing the game and that this experience is sufficiently extensive that he knows how his opponents will behave. A player need not be told about other players' actions

⁵⁶ Ibid, 14.

⁵⁷ Osborne (n 42) 1- 6, 13- 21.

⁵⁸ B Stengel, 'Equilibrium Computation for Two-Player Games in Strategic and Extensive Form' in Nisan, T Roughgarden, E Tardos, (eds) *Algorithmic Game Theory* (CUP, Cambridge 2007) 53.

⁵⁹ Osborne (n 42) 1- 6, 13- 21; H Bierman, and L Fernandez, *Game Theory with Economic Applications* (Wesley Publishing Company, Wokingham 1993) 81. The author would like to thank professor Andrew Scott for his comments on this issue.

⁶⁰ Osborne (n 42) 13- 31.

because he knows those actions from his previous involvement in the game.⁶¹ A very significant point to note here is that the experience of players in previous games does not make them familiar with the behaviour of other players hence the player does not condition his action on the opponent he faces. That is why the assumption is that each player views each play of the game in isolation.⁶² A Nash equilibrium is an action profile 1 where no player can do better by choosing an action different from 1 providing that both players play the game.

4.3.2 The Prisoner's Game: Preference Identification Strategies

This game consists of three elements: a set of players, usually two players but they can be more (our game contains two arrested prisoners), possible actions for each player and the process of deciding what these actions are, a key point in game theory. The game provides two actions for each prisoner: keep quiet or confess. Finally, the Prisoner's Game contains a set of preferences for every set of choices or outcomes by the players.⁶³ Now, the first prisoner is called prisoner 1 and the second is known as prisoner 2. Both have been arrested for a number of crimes and they can both be sentenced for a minor offence but there is not enough evidence to convict them for the major crime unless one of them informs against the other. If they both stay quiet (therein after: Q), they will only be convicted for the minor offence for a short time. However, if one of them, only one, confesses (therein after: C) and gives evidence about the other, the confessing party will be freed and then be used as a witness against the other, who will be sentenced for a very long time. If both suspects speak, however, they will both get a reduced sentence. Now, both prisoner 1 and prisoner 2 have the choice to keep quiet or to confess. So both of them have the same options and both of them have preferences. The most important part of the game is to establish all the actions that every player might have and, at the same time, the outcome of these actions (preferences).

The diagram below indicates these options and their interrelationship.

⁶¹ Ibid. In some cases however players do not have experience with the game or they might not view other players in isolation; Ibid, 27- 28.

⁶² Ibid, 21.

⁶³ Osborne (n 42) 13. The same source will be used to explain the technique of the game.

		Prisoner 2	
		Q	C
Prisoner 1	Q	2, 2	0, 3
	C	3, 0	1, 1

The preferences of prisoner 1 from worse to best are as follows. The worst outcome for him is if he keeps quiet and prisoner 2 confesses. In this case his preference will be (0) because he will be locked up and prisoner 2 will be set free. The second less preferred outcome would be if they both confess since they both will get reduced sentences. In this case, the preference of prisoner 1 will be (1). But if they both keep quiet (and taking into account the lack of evidence) they both will have a short sentence. Prisoner 1's preference in this case is (2). However, the best preference for him will be if he confesses and prisoner 2 keeps quiet. In this case, he will be set free and prisoner 2 will be locked behind bars for a long time. Here, the preferences of prisoner 1 scores (3).

Prisoner 2 has the same options and preferences but in reverse. His less preferred outcome would be where prisoner 1 gets 3. The second less preferred outcome would be when they both get 1. The next less preferred when they get 2. And his best outcome would be where he gets 3 and is therefore set free and prisoner 1 gets 0 and is locked up for long time.

4.3.2.1 The Solution to the Game: Nash Equilibrium

In the above game, Nash's equilibrium (solution) is used to evaluate the players' actions and preferences. The key idea here is to consider the strategies of both players such as keeping quiet or confessing to identify the exact action profile where both players have no interest whatsoever in changing their minds (actions), otherwise, they will be worse off. In our game (discussed above), this position occurs where both

players select preference 1. This is because if prisoner 1 changes his mind, the outcome will be worse for him. He will be locked up for long time and prisoner 2 will be set free. So he has no incentive to change his outcome (action). The same thing is true for prisoner 2. Hence both players have no incentive to change their mind where they both get preference 1. According to Nash, this is the solution of the game. As such, we can only have Nash equilibrium where both players have preference 1. The reason why we do not have Nash's solution where the players have preferences 3, 2, or 0, is that in these cases both players have a strong incentive to change their minds. For instance, let us choose the case where prisoner 1 has preference (3) and prisoner 2 preference is (0). In this case prisoner 1 has no incentive to change his mind because in this position he will be set free. However, prisoner 2 has a very strong incentive to confess about prisoner 1 since keeping quiet is the worst outcome for him. If the prisoner 2 speaks, he and prisoner 1 will get a reduced sentence. But if he keeps quiet, he will be locked up for a long time. That is why we do not have the Nash equilibrium here (no game) and the same is true in the case where the players' preferences score 2 or 3.

Keeping Nash's solution in mind and considering the fact that a trader and a consumer operate in a similar context of uncertainty as to how the other will react if certain actions are taken, the game theory analysis could apply to the trader-consumer relationship. In theory, a trade mark owner (assumed to be rational and always seeks to achieve long term profit) has a strong incentive to maintain a good reputation, and thus good quality products. If he does not, a consumer (assumed to be rational) is likely to switch to a substitutable product. Accordingly, one Nash equilibrium (solution) may indeed be the state where the trader has an incentive to maintain the quality of goods sold under his mark to retain the loyalty of a consumer, and the consumer has an incentive to continue buying the product because of its quality. This argument however does not exclude all other possibilities. For instance, what would the implication of game theory analysis on a trader-consumer relationship be if the rationality assumptions of the Chicago School can be challenged? Put differently, what if the trader is able to retain the loyalty of the consumer without having to maintain the quality of goods?

Based on the foregoing, one immediate question emerges: how does the Chicago economist come to the conclusion that market forces are sufficient to enforce traders to maintain the quality of their branded goods, and thus there is no need to enforce this function by law?

4.4 Game Theory and the Enforcement of the Quality Guarantee: Chicago Approach

Chicago economists acknowledge the fact that trade mark protection does not reduce consumer search costs unless the trader of branded goods maintains a consistent level of quality ‘over time and across consumers’.⁶⁴ Nevertheless, as discussed in chapter one, Landes and Posner argue that a trader is unlikely to develop a strong brand unless he is able to maintain the quality of the product to which the mark is attached.⁶⁵ This assumption is built on one of the fundamental building blocks of the Chicago law and economics movement: individuals (and entities) are rational profit maximisers.⁶⁶ As such, Chicago economists appear to assume that consumers are watchful and would realize when a trader reduces the quality of his branded goods and, as a result, would abandon the mark by switching to a competitor’s product. This commercial loss is thought to be adequate and effective to prevent traders from lowering the standard of their goods in the first place. Chicago’s positive or what we might loosely call ‘deregulation’ approach is based on the notion that market forces provide a reliable enforcement mechanism that ensures the protection of the interests of consumers as to quality issues under trade mark law.⁶⁷ Posner points out:

The investment that a producer makes in his trademark is like a hostage: It increases the cost to the producer of surreptitiously reducing the quality of the product or otherwise trying to deceive consumers, because when they catch on, the producer may lose his entire investment...He may even if they don’t catch on, because failure to maintain quality control is a legal bar to enforcing a trademark against an infringing competitor.⁶⁸

⁶⁴ Landes and Posner (n 2) 269.

⁶⁵ Chapter one, 14.

⁶⁶ For more information about Chicago economics see Mercurio and Medema (n 18) 102.

⁶⁷ See page, 151.

⁶⁸ Posner (n 3); see also C Shapiro, ‘Premium for High Quality Products as Returns to Reputation’ (1983) 98 QJE 659; Similar remarks were made by other Chicago economists where they argue that an efficient structure of private property rights will emerge as a result of market forces. G Furubotn, R Richter, ‘The New Institutional Economics: An Assessment’ in G Furubotn, R Richter, (eds) *The New Institutional Economics* (Texas University Press, College Station 1991a) 16; D Libecap, *Contracting for Property Rights* (CUP, Cambridge 1989a) 16. Still, some acknowledge that self-interested individuals may fail to live up to their past promises; even in the case of contractual relationship hence some enforcement mechanism is necessary. The problem however is that, although enforcement

The Chicago law and economics movement has had a profound impact on the enforcement of the quality guarantee under trade mark law. For the vast majority of trade mark scholars, that function is perceived as an economic one that should not be enforced under trade mark law.

Despite its surface appeal, on deeper scrutiny, the Chicago deregulation approach concerning the enforcement of the trade mark quality function suffers from a few major flaws. The controversy rests on applying game theory analysis and Nash's solution to a trader-consumers relationship. To this end, the Chicago School employs a cluster of unrealistic and hotly contested postulates such as perfect competition, consumer rational behaviour and wealth maximisation. As the proceeding parts of this chapter will show however, contrary to the Chicago School approach, consumers are not rational. Furthermore, the notion that traders have economic interests not to reduce the quality of their branded goods is not always accurate. To this we shall now turn.

5. Chicago School Critique

In the paradigm governing the enforcement of the quality guarantee, the Chicago approach is untenable. Firstly, maintaining quality control is not a legal bar to enforcing a trade mark against an infringing competitor under trade mark law.⁶⁹ Even under consumer protection law, the traders of branded goods are required to maintain a satisfactory quality which is not the same as maintaining a consistent quality.⁷⁰

reduces uncertainty in the market, it is costly. This includes the cost of establishing an enforcement mechanism and the cost of detecting violations and imposing penalties on the violators. This means that enforcement in the case of some property rights will be less perfect. D North, *Institutions, Institutional Change, and Economic Performance* (CUP, Cambridge 1990b) 33, 58; D North, 'Institutions and Economic Performance' in U Maki, B Gustafsson, and C Knudsen, (eds) *Rationality, Institutions and Economic Methodology* (Routledge, London 1993b) 247.

⁶⁹ Chapter two, 17; Case C- 9/93 *IHT Internationale Heiztechnik v Ideal-Standard* [1994] 3 CMLR 857, para 38.

⁷⁰ Sections 14 (2) and (2 A) of the Sale of Goods Act 1979 as amended (SGA) regulate quality matters. Section 14 (2) reads: 'Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality'.

Secondly, Chicago economists build their assumptions on the model of perfect competition rather than on workable competition.⁷¹ The problem however is that this model (perfect competition) is based on assumptions unlikely to be observed in practice. As such, the notion that individuals (or entities) are rational and that they always attempt to maximise profits is not always accurate. Some might be interested in expanding the size of their businesses more than maximising their profit. Others may be more interested in indulging themselves in the quiet life at the expense of their wealth.⁷² Further, considering the idea that Nash equilibrium occurs only where individuals (players) have no interests to change their minds (actions), it appears that the Chicago School of economics has built its quality maintenance assumption on a static model of economic behaviour which may fail to account for the dynamic nature of markets. As such, even where the traders of branded goods might be interested in maximising their profit, this in itself, does not necessarily mean that they are going to maintain the quality of their goods. While the act of maintaining consistent quality may be important for a certain period of time to retain the loyalty of consumers, the cost of doing so becomes economically unsustainable (and irrational according to Nash solution of the game) whenever the dynamic nature of markets has changed such as in the case of the increase in the price of raw materials or where the traders were able to retain the loyalty of consumers by using cheaper methods such as advertising. In this case, the traders have a strong incentive to change their minds (action), and hence not to maintain consistent quality.

Thirdly and closely related to the second point, the Chicago approach largely ignores the role of forces such as social norms on individual behaviour.⁷³ The inclusion of social norms into the trade mark-consumer relationship makes for robust explanations of consumer behaviour and more accurate prediction of the effects of legal protection.⁷⁴ It should be evident, given the advertising and persuading impact of

⁷¹ Posner observes that the Kinked demand curve (workable competition) ‘cut-throat competition, leverage, administrated prices, and the other characteristic concepts of the industrial organisation of this period had this in common: they were not derived from and were often inconsistent with economic theory, and in particular with the premises of rational profit maximisation’; R Posner, ‘The Chicago School of Antitrust Analysis’ (1978) 127 U Pennsylvania L Rev 931.

⁷² A Jones, and B Sufrin, *EC Competition Law* (3rd edn, OUP, Oxford 2008) 12; Whish (n 16) 3- 7.

⁷³ The study of social norms in law and economics is often attributed to R Ellickson, *Order without Law: How Neighbours Settle Disputes* (Harvard University Press, Harvard 1991).

⁷⁴ Some Chicago theorists such as C Sustein, D Kahan, L Lessig and R Pildes (usually called the new Chicago school) argue that law should help to reform and change social norms. McAdams points out

brands on consumer commercial behaviour, that there is something fundamental about the nature of consumer interaction that is not adequately explained by the extant models of human behaviour found in law and economics, in particular the rational-choice based approach used by Chicago School.⁷⁵ By stressing the concepts of rational individuals and wealth maximisation, the Chicago approach to law and economics intentionally or unintentionally exaggerates the role of market forces, and thus minimises the need for legal intervention to enforce the quality function under trade mark law.

The Chicago quality approach suffers three major drawbacks which deserve further scrutiny. Firstly, the notion that information provided by trade marks in a perfect competition system reduces consumer searching costs is not straightforward. On the one hand, there is lack of certainty as what is guaranteed under a trade mark and, on the other, there are a few cases where information provided by marks actually increases rather than decreases searching costs. Secondly, are consumers truly rational and always interested in maximising their own material wealth as anticipated by Chicago economists? This concept will be tested. Thirdly, the interests of traders to retain the loyalty of consumers by maintaining consistent quality are not static. Today's market provides many examples which indicate that it is very difficult to anticipate how individuals (entities) will behave in a given situation. In the context of trader-consumer relationship, this means it is not always possible to link the notion of wealth maximisation and quality maintenance.

5.1 The Interplay between Quality, Information and Search Costs

In this part we ask a question: what information does a trade mark convey to a consumer? According to the TM Directive and the interpretation of the Court of Justice, a trade mark serves mainly as a badge of origin. It therefore relates X product to a particular trader who might be held responsible for its quality.⁷⁶ However, it is

that 'arguably, the most important relationship between law and norms is the ability of law to shape norms'... 'If legal rules sometimes change or create norms, one can not adequately compare an existing legal rule with its alternatives without considering how a change in the law rules may affect the relevant norms'. R McAdams, 'The Origin, Development, and Regulation of Norms' (1997) 96 Michigan L Rev 354. This new approach however was strongly opposed by Posner who described it as 'totalitarian', cited in Mercurio and Medema (n 18) 320.

⁷⁵ For information about social norms and law and economics see Ibid, 336- 341.

⁷⁶ Chapter two, 64- 66.

not possible to pin down what exactly is guaranteed to consumers under the origin function. Some argue that under trade mark law, the origin function provides a guarantee to neither a product's function nor its fitness for purpose.⁷⁷ After all, these goals are already guaranteed under consumer protection law. The origin function also does not guarantee that the product has been made in a particular way or at a particular place. It only provides assurance that the product has been made under the authority of a single entity.⁷⁸ But such authority does not convey too much information because there is usually complete separation between those who make authorization decisions and those who actually make the product. It could be argued, therefore, that a firm's responsibility as to the product they make does not necessarily have any kind of obligation and confers no rights to consumers under trade mark law.⁷⁹ As one observer points out: 'to a cynical economist, it seems that the only thing guaranteed to the consumer is that the trade mark owner will take a share of the profits on the sale of the product'.⁸⁰

In the case of a mark with a reputation, the informative role of the mark becomes even more elusive. The function of the mark with a reputation is not restricted to indicate the origin or quality of a product. On the contrary, the mark may communicate or advertise the product in question. However, as far as the quality of information is concerned the mark with a reputation reveals very little information to consumers. Instead, the advertising value of the mark seeks to create an emotional tie. Creating an emotional tie with consumers, however, does not require too much information. On the contrary, it is about saying as little as possible in the hope of encouraging consumers to create their own positive impression about the product. In that sense, an Apple 3GS phone becomes a must buy item for many consumers despite the fact that there are hundreds of other, significantly cheaper handsets, that do exactly what the 3GS does. Still it is the image and prestige of this particular handset, not necessarily its specifications, that fuels consumers' imaginations.

⁷⁷ Aldred (n 5) 269.

⁷⁸ Chapter two, 64- 66.

⁷⁹ Aldred (n 5) 269.

⁸⁰ Ibid.

Further, more information does not necessarily mean less searching costs. The information provided by a mark might be false,⁸¹ inaccurate or it might contain overestimated claims about the quality of the product that cannot be checked.⁸² Even if the information provided by the mark is very accurate, it can, nonetheless, still mislead consumers. For instance, if the advertised mark concentrates on one piece of information or a character of the branded goods that the consumer assumes its uniqueness but, in reality, other competing products contain the same character, this information misleads the public even where it is quite accurate.⁸³ A good example can be found in the digital cameras market where the attention is mostly based on one or two aspects of the product, such as how many pixels a camera has despite the fact that the pixel is not the most important part of the camera.⁸⁴ Yet, many camera brands stress this point as many consumers believe that the more pixels you have the better quality picture you get.

5.2 When does a Trade Mark Increase Searching Costs?

The notion that a trade mark increases consumer welfare by reducing searching costs is not straightforward. The information provided by the mark does not always reduce searching costs. While consumers feel more satisfied and less confused by using a trade mark as a source of information, in many cases, they actually end up making poorer purchasing decisions. An empirical study suggests that increasing the amount of information on a package tends to produce dysfunctional consequences in terms of the consumers' ability to select the brand which is best for them. This is despite the fact that the tested consumers felt more satisfied and certain about their choices. In other words, the test reveals that consumers felt better with more information and yet they made a poor purchasing decision.⁸⁵

⁸¹ In this case, Article 3 of the Business Protection from Misleading Marketing Regulations 2008 might be invoked (implementing Directive 2006/114/EC of the European Parliament and of the Council concerning misleading and comparative advertising [2006] OJ L376/21).

⁸² H Rosler, 'Anti-Counterfeiting in Online Auctions from the Perspective of Consumer's Interests' (2006) 37 ICC 780.

⁸³ I Ramsay, *Consumer Protection: Text and Materials* (Butterworths, London 1989) 416.

⁸⁴ Pixel has to do with the size of printing not the quality of a picture. The larger the size of the photograph, the more pixel you need. 6 Million MP is enough to print up to A4 size.

⁸⁵ J Jacoby, D Speller, C Kohn, 'Brand Choice Behaviour as a Function of Information Load' (1974) 11 J Marketing Research 67.

What is more, for consumers who have a favoured brand, the impact of the mark in reducing searching cost becomes insignificant. In order for the mark to reduce search cost, there must be some sort of brand uncertainty.⁸⁶ An empirical study concludes that although the theory of reducing consumer's cost makes sense, it does not offer much in the way of testable predictions'.⁸⁷ The study reveals that consumers who have some brand preference might stop looking for other competitive alternatives which might have a similar or better quality.⁸⁸ That is, Robert Feinberg questions the notion of information and reducing consumer's search cost.⁸⁹ He argues that when considering the benefit of the trade mark in providing information about the quality differentials thus reducing searching costs, one must consider the question of time. That is, the price differential between a dominant brand (e.g. Canon) that has more than 70 years of experience and was one of the first cameras makers to enter the market, and a competitor brand (e.g. Sony) is significant. However, over time, it is likely that the quality differentials between these two cameras makers would narrow. The Canon mark nevertheless may continue to perpetuate the original, yet not longer accurate, differentials. This is despite the fact that the information provided by the Canon mark might not have the same value when other competitors have improved the quality of their products.⁹⁰ In this case, the continuous reliance on the Canon mark might have reverse impact, and thus increase rather than decrease searching costs. Thus, as Feinberg puts it:

The discrepancy between actual and perceived quality would be longer-lived and hence more damaging to... [Sony] competitors, the larger the dominant brand's [Canon] share of the market. This follows if experience with... [Sony] brands are the mechanism by which perceived quality differentials are narrowed.⁹¹

In other words, the difference in quality between Canon and Sony cameras might become insignificant and, therefore, does not economically justify price differences. Yet, Canon's reputation as cameras marker still enjoys a strong competitive advantage

⁸⁶ S Moorthy, B Ratchford, D Talukdar, 'Consumer Information Search Revisited: Theory and Empirical Analysis' (1997) 23 J Consumer Research 263- 277.

⁸⁷ Ibid, 264.

⁸⁸ For more information about the impact of trade mark in reducing search cost in case of totally differentiated, independent priors; partially differentiated, independent priors; homogeneous independent priors and homogeneous priors and brands see Ibid, 263- 277, 267- 268.

⁸⁹ R Feinberg, 'Trademarks, Market Power, and Information' (1985) 2 Rev of Industrial Organization 376- 385.

⁹⁰ Ibid, 376.

⁹¹ Id.

against other competitors, hence charging a high price for their products which might be similar to much cheaper substitutes already available in the market. This, in turn, means that for consumers who have a brand preference, relying on the trade mark as a source of information might actually increase their searching costs.

5.3 Chicago Concept of Rational Consumer Retested

Chicago economists consider consumers rational players able to estimate the likely outcomes of uncertain decisions and to select the outcome which maximises their welfare at the time the decision is made. In turn, this assumed rationality means that consumers should be held countable for their purchasing decisions. Hence, if a trader reduces the quality of his branded goods, the theory is that consumers will simply switch to a different product, but do they?

Today's markets provide a wealth of evidence that contradicts the Chicago notion of consumer rationality. A close look at the markets reveals that many of the advertised aspects of branded products such as colour, shape, image or design are not of a great benefit to consumers but still capable of luring their purchasing choices. This is particularly true in the case of luxury products where the reputation of the mark or its design might create a false impression of superior quality, the so-called sensation transference.⁹² In an experiment to investigate the impact of design in luring consumers' purchasing decisions, a group of women were given the same cosmetic product in two different shape bottles, circular and triangular. 80% of the tested women believed that the product with the circle design is of a higher quality than that in the triangle.⁹³ This experiment shows that consumers can be easily duped.

The impact of the artificial components of a product in luring consumer purchasing decisions however is not limited to luxury goods. Indeed, contrary to the Chicago notion of rational individuals, modern marketing provides significant evidence that consumers are not rational and, hence, at least from marketing point of view, it is

⁹² Rosler (n 82) 775- 780.

⁹³ V Packard, *The Hidden Persuaders* (Penguin, Harmondsworth 1981) 239. By stark contrast, Chicago economists, including Landes, Posner, Becker and Stigler have claimed that advertising is essentially informative rather than manipulative; see chapter three, 40; G Hodgson, 'The Hidden Persuaders: Institutions and Individuals in Economic Theory' (2003) 27 Cambridge JE 159- 175.

dangerous to assume that they will behave in a rational way.⁹⁴ For instance, in an experiment to test the impact of package design for a new detergent in customer purchasing decisions, a number of women were given the product in three different boxes.⁹⁵ One box was yellow, the second was blue and the third was blue with splashes of yellow. The tested women were given the impression that they had been given different products. In reality however, the detergent was the same. When reporting back, some women stated that the detergent in the yellow box was too strong; in some cases it even ruined their clothes. By contrast, they complained that detergent in the blue box was not strong enough and, in some cases, it actually left their clothes dirty. The overwhelming majority reported that the third box, which contained what the tested women felt was an ideal balance of colours in the package design, was wonderful.⁹⁶ In another case, a department store tried an experiment. The manager increased the price of slow-moving items from 14 cents to two for twenty nine cents. Sales immediately increased 30 percent when customers offered the items at this 'bargain' price.⁹⁷

The importance of artificial product differentiation in general, and the role of trade marks in particular, become very significant where the branded goods are essentially alike in physical characteristics. The greater the similarity between branded products is, the less reason to choose one over the other. With the growth of standardisation, it becomes noticeable difficult to rationally differentiate between products (differentiation based on the quality of branded goods). This makes the role of brand loyalty in influencing, shaping and directing consumer commercial behaviour very crucial indeed.⁹⁸ To enhance brands loyalty, traders sell varied range of emotional components such as security, love, sense of power, sense of roots and so on and so forth.⁹⁹

5.3.1 The Rational Consumer: What is the Criterion?

⁹⁴ V Packard, *The Hidden Persuaders* (Ig Publishing, New York 2007) 38.

⁹⁵ *Ibid*, 37- 42.

⁹⁶ *Id*.

⁹⁷ *Ibid*, 40.

⁹⁸ *Ibid*, 45, 66.

⁹⁹ *Ibid*, 86- 94.

One of the criticisms of game theory discussed early in this chapter is that, unlike entities, it is not possible to reasonably differentiate a rational from an irrational consumer. This is because consumer commercial conducts are subjects to a wide range of elements that the Chicago concept of rationality does not account for. For instance, how many of you have done your shopping on an empty stomach only to end up home with dozens of things that you do not necessarily need?¹⁰⁰ How many of you have the experience of placing an order by phone for warm clothes on a cold night only to discover that what you ordered is unsuitable or does not fit?¹⁰¹ How many of you have the experience of joining a gym or health club and barely using them? The answer is possibly many of you. And the reason for such economically unwise behaviour is that when we do our shopping on an empty stomach or order warm clothes via phone our purchasing conduct is heavily influenced by our emotional state. When we joined the gym we mainly focused on the benefit of doing so rather than on how it feels to get up early in the morning and to exercise very hard for an hour or so.¹⁰² Vigna and Malmendier explain this phenomenon by suggesting that ‘making inferences from observed contract choice under the rational expectation hypothesis can lead to biases in the estimation of consumer preferences’.¹⁰³ The conclusion that can be derived from these examples is that when it comes to purchasing satisfaction and choosing the correct product, consumers usually are unable to choose the best product for themselves.¹⁰⁴ Thus, the Chicago notion of rational consumer is, at best, unrealistic and it ignores the impact of social norms, branding and marketing in shaping consumer purchasing decisions.

5.3.2 The Impact of Wealth Maximisation in Reducing Quality: Rethinking Nash’s Equilibrium

As discussed, the concept of the ‘self-enforcing feature’ of a trade mark (coined by Landes and Posner) is based on game-theoretic analysis. The problem however is that it is difficult to anticipate a certain outcome all the time depending on game analysis

¹⁰⁰ R Nisbett, and D Danouse, ‘Obesity, Hunger, and Supermarket Shopping Behaviour’ (1986) 3 Proceedings of the Annual Convention of the American Psychological Association 683.

¹⁰¹ D Kahneman, and R Thaler, ‘Utility Maximization and Experienced Utility’ (2006) 20 J Economic Perspectives 224.

¹⁰² S Vigna, and U Malmendier, ‘Paying Not to Go to the Gym’ (2006) 96 American Economic Rev 694.

¹⁰³ Ibid.

¹⁰⁴ Kahneman and Thaler (n 101) 221.

alone.¹⁰⁵ This is because contrary to the Chicago concept of wealth maximisation under the perfect competition system, a trader's commercial conduct is subject *not* only to his own interest but also to the dynamic of the market. Thus, the promise of maintaining consistent quality is not solely related to the interest of the trader himself.

According to the Prisoner's Dilemma discussed above (the game), the trader and consumer (players) work together only because it is in their own interests to do so. As such, any change in the position of the players or their interests would lead to a completely different result from that anticipated by the Chicago School regarding the enforcement of the quality issues. According to the game, if any of the factors that encourage a trader to maintain the quality of his branded goods changes due, for instance, to the availability of other cheaper methods to retain the loyalty of consumers such as advertising or because of the increase of prices of raw materials, a trader, who is assumed rational and always seeks to maximise his own material benefits, would have a strong incentive not to maintain the quality of his branded goods. In the same way, a trader may decide that the short-term increase of profits results from reducing quality combined with increase in sales outweighs the 'long-run deterioration in reputation and sales once consumers discover that product quality has declined'.¹⁰⁶ This scenario is plausible and confirmed by Posner himself who points out that the notion that a trader has an interest to maintain the quality of his branded goods is not true 'if the producer could withdraw from the market at zero cost'.¹⁰⁷ According to this interpretation, trade marks may indeed indicate a certain level of quality but they do not necessarily maintain consistency of quality.¹⁰⁸

In his study to investigate the equilibrium of price-quality for markets in which buyers cannot observe product quality prior to purchase, Carl Shapiro has argued that there is an 'incentive for sellers to reduce quality and take short-run gains before buyers catch on'.¹⁰⁹ The study maintains that where the product attributes are difficult to observe prior to purchase, consumers usually rely on a trade mark reputation as an indication of quality (where they can link the pleasant experience of the past buy as an indicator

¹⁰⁵ Aldred (n 5) 270.

¹⁰⁶ Ibid; Shapiro (n 68) 659- 680.

¹⁰⁷ Posner (n 3).

¹⁰⁸ Similar remarks were made by Aldred (n 5) 270.

¹⁰⁹ Shapiro (n 68) 659.

of present or future quality).¹¹⁰ The benefits of producing quality products and charging a premium, however, cannot be harvested instantly. The trade mark owner has first to conduct a quality merchandising campaign to build up a reputation before being able to achieve any profits. This is because at the beginning he has to sell the products for less or very close to marginal cost if he is to enter the market and to establish his reputation. Whenever the reputation has been established, however, the seller can charge a premium for his quality product which represents the return on the initial investment in reputation.¹¹¹ Nonetheless, the ability of the seller to maintain a consistent level of quality lies entirely on his ability to charge a premium because branded product costs more than unbranded one.¹¹² If he is not able to sell the product at a premium price, i.e. due to the increase in the price of raw materials or any other competitive factors, the notion of maintaining a consistent level of quality will not be an economically sound option. In this case, the seller might find a fly-by-night strategy of quality reduction very appealing. This is because reducing the level of quality provides instant profit in comparison with building a reputation which takes time and money.¹¹³ This is not to suggest that this is the case for all branded goods. Rather the suggestion here is that the risk of reducing the quality of branded goods under the concept of the self-enforcing feature of the mark is not only real but also appealing.

5.4 Wealth Maximisation and the Question of Quality Maintenance: Lessons from the Market

The incentive to maintain a consistent level of quality and therefore the reputation of a mark might be related where the decision makers in a firm are interested in future profits. Does that mean traders always maintain consistent quality? This may not always be the case. This is because the decision to maintain or not to maintain consistent quality is influenced by a wide range of competitive factors on the market such as the availability of other cheaper substitutes, bonuses and other payment-related issues. The current global financial crisis is a revealing testimony on an international scale as to how the decision makers in a given market can be more

¹¹⁰ Ibid, 659- 680, 659.

¹¹¹ Id, 660.

¹¹² Id.

¹¹³ Id.

interested in increasing their salaries and bonuses rather than those of the shareholders. As such, sacrificing the firm's long-term reputation for the sake of very high profits in the short term might be seen as a sound option.¹¹⁴ The world has witnessed the near collapse of many giant entities once considered by millions of customers as the ultimate source of robustness, confidence, reliability and consistency in the quality of their goods and services. Two years ago, one would have thought it partially impossible to imagine that entities such as Lehman Brothers and the Royal Bank of Scotland would go bankrupt and they would need to be bailed out. After all, these firms are as big and profitable as it gets and they are supposedly long-term profit seekers. So how have these entities come to such a catastrophic economic position? The answer is that, among many other factors, the lack of regulation and the level of financial risk that has been taken by the policy makers of these companies was very high.¹¹⁵

The lesson that can be derived from the financial crisis is that even when traders may be interested in long-term profit, this does not mean that they are going to do the right thing for consumers, and thus maintain the quality of their branded goods. This convenient, yet untested, link between wealth maximisation and quality maintenance was made by Posner to advance a deregulation policy.¹¹⁶ If history is any indicator however, the Chicago deregulation approach can damage the competition system and consumers alike.¹¹⁷

¹¹⁴ OECD, *The Financial Crisis: Reform and Exit Strategies* (Organization for Economic Co-operation and Development, Paris 2010) 25; A Wignall, P Atkinson, and S Lee, 'The Current Financial Crisis: Causes and Policy Issues', <<http://www.oecd.org/dataoecd/47/26/41942872.pdf>> accessed 12 June 2010; see D Lynch, 'Commissioners blast 2 former top executives at Citigroup' (8 April 2010) <<http://fcic.gov/>> accessed 12 June 2010; BBC, 'Bank of England fears bank risks' (29 June 2007) <<http://news.bbc.co.uk/1/hi/business/6253752.stm>> accessed 12 June 2010; BBC, 'G20 declaration: Full text' (15 November 2008) <<http://news.bbc.co.uk/1/hi/business/7731741.stm>> accessed 12 June 2010.

¹¹⁵ G Zalm, 'The Forgotten Risk: Financial Incentives' (2009) 157 *De Economist* 209- 213.

¹¹⁶ Posner (n 3).

¹¹⁷ Chicago economists' adherence to the notion of extreme deregulation is not new. On the aftermath of the Great depression (1929), very few people were interested in the notion that a free market is a perfect scientific system, 'one in which individuals, acting on their own self-interested desires, created the maximum benefits for all'. Accordingly to Klein, Chicago economists used, through an 'aura of scientific impartiality', their extremely well corporate funded ideology to reaffirm the importance of the same deregulation principles that caused the biggest financial catastrophe in the twentieth century in the first place; N Klein, *The Shock Doctrine* (Penguin Group, London 2007) 56.

The Chicago notion of wealth maximisation and hence long-term profit seeking may encourage traders to maintain consistent quality products. However, it is not always wise to simply rely on market forces and thus the interests of traders to protect the interests of consumers without considering all factors that influence consumers and traders' commercial conducts in the first place. Based on perfect competition, Chicago deregulation approach ignores market reality. It is a simplistic reduction to simply summarize quality issues and their complicated implications for both traders and consumers by suggesting that traders have an economic interest to maintain the quality of their goods and, therefore, do not allow the quality of the product sold under their banner to decline, and that this alone ensures consumer's interest in having quality products. This is because traders perceive the quality function as a vehicle to retain the loyalty of consumer *only* as long as there is no other more profitable ways for doing so.¹¹⁸

5.4.1 Do Trade Marks Convey Consistent Quality: The Toyota Example

Perhaps the most revealing example as to the deficiency of Chicago's key reliance on market forces to enforce the maintaining of consistent quality by traders, hence the link between long term profit and quality consistency, is Toyota's latest crisis. Toyota is the world's number one selling carmaker. In 2009 alone, it sold 7.8 million vehicles worldwide.¹¹⁹ Toyota is renowned for its quality and reliability. Due to a rise in raw material costs and the collapse of the auto market in Europe and North America on the aftermath of the global financial crisis, Toyota reported a record annual loss of \$4.4 bn.¹²⁰ In order to cut costs, some car manufacturers resorted to the use of the same components across a range of models.¹²¹ This is thought to increase the number of recalls.

¹¹⁸ Chapter three, 37- 41.

¹¹⁹ R Booth, and J McCurry, 'Toyota in crisis as Prius admission leads to threat of second recall' (4 February 2010) <<http://www.guardian.co.uk/business/2010/feb/04/toyota-crisis-recall-prius-brake>> accessed 12 June 2010; BBC NEWS, 'Toyota considers Corolla recall over steering problems' (17 February 2010) <<http://news.bbc.co.uk/1/hi/business/8519534.stm>> accessed 12 June 2010; Aljazeera News, 'US to probe Toyota brake failure' <<http://english.aljazeera.net/business/2010/02/20102420173126205.html>> accessed 12 June 2010.

¹²⁰ K. Voigt, 'Toyota posts profits but recall questions loom', (4 February 2010) <<http://edition.cnn.com/2010/BUSINESS/02/04/toyota.japan.earnings/>> accessed 12 June 2010.

¹²¹ This policy of cutting costs is not new. See BBC NEWS, 'Toyota to Tackle Quality Control' (25 August 2006) <<http://news.bbc.co.uk/1/hi/business/5285196.stm>> accessed 12 June 2010.

By 2010 and due to a problem with uncontrolled acceleration, Toyota has recalled over 8 million cars worldwide. Interestingly, it appeared that Toyota was aware of the problem as early as the winter of 2008 where there had been reports of a stiff accelerator pedal. When Toyota's UK spokesman was asked why Toyota did nothing to sort the problem out until 2009-10, he pointed out that these concerns '*were a quality rather than a safety issue*'.¹²² The recall is said to cost Toyota \$2 billion.¹²³ As a response to the allegations that Toyota sacrificed the quality of its brand, the firm's president has pledged to create a new global quality committee where Toyota will employ new quality control offices.¹²⁴

Toyota was not the first or the only automaker that recalls vehicles. In 2003, Nissan recalled over 2.5 million cars worldwide,¹²⁵ Chrysler recalled about 438,000 Jeep Liberty SUVs in the same year¹²⁶ and recently in 2008 Ford Motor Co. called 4.5 million older-model vehicles because of defective cruise control.¹²⁷ These are only a few examples.

Keeping the Chicago law and economics approach in mind, the Toyota example must raise serious cause for concern. The assumption that individuals (including entities) are rational players who always seek to maximise their own long term payoff is not always related to quality maintenance. As we repeatedly mentioned throughout this thesis,¹²⁸ quality maintenance is relevant only when doing so is the cheapest way to retain the loyalty of consumers. This is because, as mentioned before, the interests of traders in maintaining consistent quality is affected by the dynamic nature of the market which seems to be largely ignored by the Chicago School.

¹²² BBC NEWS, 'Toyota shares fall as woes mount' (3 February 2010) <<http://news.bbc.co.uk/1/hi/business/8496465.stm>> accessed 12 June 2010.

¹²³ Voigt (n 120).

¹²⁴ M Voss, 'Remarks by TMC President Akio Toyoda Following the Inaugural Meeting of the Special Committee for Global Quality' (2010) <www.toyota.com/recall> accessed 12 June 2010.

¹²⁵ <http://www.consumeraffairs.com/news03/nissan_recall.html#ixzz0ko5yBQB3> accessed 12 June 2010.

¹²⁶ <http://www.consumeraffairs.com/news03/jeep_recall.html#ixzz0ko6Rmkxz> accessed 12 June 2010.

¹²⁷ T Krisher, and S Manning, 'Ford Recalls 4.5 Million Vehicles Over Defective Cruise Control Switch' (13 October 2009) <http://www.huffingtonpost.com/wires/2009/10/13/ford-adds-45m-vehicles-to_ws_318945.html> accessed 12 June 2010.

¹²⁸ Chapter one, 26; Chapter three, 38- 41.

What is more, the fact that, after massive global recall, in the United States alone, Toyota reported an increase of 35.3 percent in sales in March 2010 over the same period last year.¹²⁹ As a result, despite a previous forecast of a \$ 2.2 billion loss this year, Toyota projected to end the fiscal year on an \$880 million profit.¹³⁰ Thus, the notion that if a trader reduces the quality of his goods he will incur business loss (the self-enforcing feature of a trade mark) and this is by itself adequate protection of the interests of consumers as to quality issues, is clearly questionable. In the Toyota case, the interests of consumers as to quality issues were actually protected by consumer protection law rather than trade mark law. As noted before, Toyota's UK spokesman admitted that the firm did not move to sort the problem with the uncontrolled accelerator until it started to affect the health and safety of customers. Before that, Toyota ignored the issue considering its quality concerns.

Based on the foregoing, one can conclude that, contrary to the Chicago law and economics approach:

- 1- Toyota's ambition to achieve long term profit did not seem to prevent it from reducing the quality of some of its products. More importantly, this was not the first time that Toyota was forced to recall a number of its vehicles. In 2006, the firm recalled over 1.5 million cars and promised to tackle quality control.¹³¹
- 2- Toyota also did not report heavy loss. Actually, as noted, it managed to achieve some profits.
- 3- Toyota did not lose too many customers. In fact, it succeeded in increasing its sales figures by 35%.
- 4- In the light of the above, it seems reasonable to assume that, if the faulty accelerator had not raised safety issues, Toyota would not have had to recall any of its cars. As such, a few immediate questions emerge: Are quality and product safety the same thing? If not: why did Toyota not act until the quality issue became a safety issue? What does Toyota's failure to respond to the concerns of its customers regarding the quality of their cars teach us, keeping in mind the Chicago approach that traders have obvious economic interests not

¹²⁹ Z Zeigler, 'Toyota Reports March and First Quarter Sales' *Toyota Media relations* (1st April 2010) <<http://pressroom.toyota.com/pr/tms/news.aspx> > accessed 12 June 2010.

¹³⁰ Voigt (n 120).

¹³¹ BBC NEWS, (n 121).

to reduce the quality of their goods, and thus there is no need to enforce this function under trade mark law? These questions will be the topic of the last chapter of this thesis.

In a nutshell, trade marks may indeed indicate a certain level of quality. Considering Toyota and other related examples however, this does not necessarily mean they always indicate consistent quality.

6. Overview

If the argument of the preceding parts can be accepted, and considering the impact of the Chicago School on the enforcement of the quality function, it would appear in conclusion, that the very nature of the self-enforcing feature of a trade mark is not only questionable but may, in fact, also act to influence the direction of trade mark law in undesirable ways. The concept of the self-enforcing feature of a trade mark works in two diametrically opposite ways. While it might be true that this principle enforces a trader to maintain a consistent level of quality under a certain set of conditions, this does not always mean that the enforcement of the quality function is guaranteed.

There is an urgent need to reconsider the legal attitude towards the enforcement of the quality function under trade mark law. However, before considering that issue, a final question must be asked: why does the current legal framework on consumer protection law not rectify any unfairness uncovered in the domain of quality maintenance, for example, through section 14 (2) of the Sale of Goods Act (as amended)?

Chapter Five: The Other Side of the Coin: The Rationale of Quality Regulation under Consumer Law: Section 14(2) of the Sale of Goods Act as an Example

1. Introduction

After discussing the limitations of the principle of a self-enforcing feature of a mark (the deregulation approach) championed by the Chicago School and having evaluated its capacity to encourage traders to maintain consistent quality, in this chapter we persist in asking: should the quality guarantee be enforced under trade mark law?

The notion of invoking trade mark law to enforce the quality function of a mark has come in for scrutiny on a wide number of occasions, many of which concentrate on the difficulty of defining the standard or standards against which the concept of quality can be measured, on the one hand, and on the effectiveness of consumer protection law in doing exactly that, on the other. So, why does consumer law not sufficiently protect the interests of consumers as to quality issues? This chapter is dedicated to answering this question. It argues that the rationale of quality regulation under trade mark law is different from that under consumer protection law. For this reason, the quality function of the mark should be enforced under trade mark law.

The role of the quality guarantee under trade mark law is to differentiate between satisfactory quality goods. By contrast, the objective of this function under consumer law is to discourage the production of substandard goods.¹ That is why consumer law applies a compulsory measurable minimum quality test. However, given the fact that the quality of satisfactory goods may vary significantly, this test does not *adequately* enhance the production of quality goods nor it does reduce consumer search costs. Needless to say, this is not the place to discuss the foundation of quality regulations under consumer protection law in detail. We offer the concept of ‘satisfactory quality’ which underpins section 14 of the Sale of Goods Act of 1979 (as amended) as a leading example. This section is chosen because it provides a detail account of what does quality mean.

¹ *Balmoral Group Ltd v Borealis (UK) Ltd & Ors* [2006] EWHC 1900 (Comm), para 140; *Jewson Ltd. v. Kelly* [2003] EWCA Civ 1030, para 77; J Benjamin, *Benjamin’s sale of goods* (Sweet & Maxwell, London 2008) 29.

This chapter will begin by looking at the difference in quality between satisfactory goods. It will point out that the quality of two satisfactory products or services may vary significantly. Part 3 will then look at how section 14 (2) of the Sale of Goods Act has been interpreted to discourage the production of substandard goods. It will argue that the manner in which the concept of satisfactory quality has been implemented fails to reflect quality diversity between satisfactory goods. Finally, part 4 explains the difficulties of establishing multi-quality standards. To tackle this issue, it will suggest that the quality guarantee of a trade mark should be enforced under trade mark law.

2. Satisfactory Quality: How Many Standards are there?

The difference in quality between two satisfactory products can be very noteworthy. To clarify this point, we provide two practical examples.

2.1 Quality Diversity: Example from Academia

According to the UK academic system, both the University of Edinburgh and X University are legally recognized and capable of delivering academic services to students all over the world. Does this academic recognition mean that both universities provide the same level of quality services? The answer is perhaps not. Yet according to the law, both universities are subjected to the same level of eligibility assessments. However, when it comes to measuring the quality of the services provided by these two institutions, much more sophisticated measures are used. For this reason we have, for instance, the so-called Good Universities League Table.² And that is why Edinburgh is ranked somewhere at the top of the table meanwhile X is ranked somewhere down the ladder. But once again, from Edinburgh to X, all listed universities are qualified and fit for academic purposes. This recognition however does not mean that the quality of academic services provided by all these listed academic institutions is the same.

² The Time Online <http://extras.timesonline.co.uk/tol_gug/gooduniversityguide.php> accessed 4 May 2010; see also <<http://www.timeshighereducation.co.uk/>> accessed 4 May 2010.

2.2 Example from the Market

Another example can be found in the electronics market. Take Canon Pixma MP 600³ and Hewlett Packard (HP) C4480 printers.⁴ Both are for sale thus we can assume them both of satisfactory quality. However, there are many elements that make one of these products is much better than the other. For instance, the printing and scanning resolution of one of them is double that of the other hence the quality of printing and scanning is much better. One of these printers comes with up to 76 ML of ink in comparison with 10 ML with the other. Thus, from a quality perspective, these two printers belong in different league. That is why a consumer who is looking for a better value printer in the long run will be much better off by buying the printer with the higher resolution and more ink. Otherwise he will lose out. And it is here the role of the quality function of a mark comes into play. It helps the consumer to identify, for instance, which one of these two printers provides the best quality for a cheaper price.

The same analogy can be applied to almost all saleable goods and services. This leads us to the next question: does the concept of satisfactory quality under section 14 reflect the quality diversity available in the mark and, if not, why?

3. Satisfactory Quality: The Law

Section 14 of the SGA of 1979 (as amended) regulates quality matters. It provides a measurable and thus enforceable test of quality. It reads:

- (2) Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality.
- (2A) For the purpose of this Act, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.⁵

Section 14 (2B) expands on this by stating that the quality of goods includes:

³ <http://www.canon.co.uk/For_Home/Product_Finder/Multifunctionals/Inkjet/PIXMA_MP600/> accessed 4 May 2010.

⁴ <<http://search.hp.com/gwukeng/query.html?lang=en&qp=segment%3Ahho&hps=Home+%26+Home+Office&hpn=Desktops&la=en&cc=uk&charset=utf-8&qt=C4480>> accessed 4 May 2010.

⁵ In England, Wales and Northern Ireland, the implied term of section 14 is a condition. In Scotland however, the effect of breach depends on its materiality. P Atiyah, J Adams, and H MacQueen, *The Sale of Goods* (11th edn, Pearson education, London 2005) 164.

Their state and condition and the following (among other) are in appropriate cases aspects of the quality of goods-

- (a) fitness for all purposes for which goods of the kind in question are commonly supplied;
- (b) appearance and finish;
- (c) freedom from minor defects;
- (d) safety;
- (e) durability.⁶

When examining whether a product is of satisfactory quality, account has to be taken of how a reasonable person would regard the product as satisfactory.⁷ The test of the 'reasonable person' was discussed by the Court of Appeal in *Bramhill v Edwards*.⁸ The Court, citing *Bingaman's Sale of Goods*, pointed out:

... the reasonable person must be one who is in the position of the buyer, with his knowledge; for it would not be appropriate for the test to be that of a reasonable third party observer not acquainted with the background of the transaction.⁹

3.1 What does the Concept of Satisfactory Quality Mean?

The term 'quality' was defined by the Court of Appeal as 'the state or condition of the goods'.¹⁰ *Clegg v Andersson* was the first substantial case on the new concept of 'satisfactory quality'.¹¹ In this case the Court of Appeal was asked whether the yacht in question, as delivered, was of satisfactory quality. To answer this question, the Court observed that the quality of the yacht relies

on the price, the fitness of the Yacht for the purpose blue water ocean sailing with access to shallower harbours, the appearance and finish of the overweight keel, the existence of many minor defects, and the lack of safety or durability of the rig.¹²

The Court rejected the argument that the yacht as delivered was of satisfactory quality despite the fact that it required remedial work costing some £1,680. The Court refused to accept

⁶ For more information see P Atiyah, H MacQueen, and N Adams, *Atiyah's Sale of Goods* (12th edn, Pearson, London 2010) 143- 191; W Irvine, 'Satisfactory Quality: What does it Mean' (2004) November JBL 684; J Macleod, *Consumer Sales Law* (2nd edn, Routledge, London 2007) 495.

⁷ R Christou, *Sale and Supply of Goods and Services* (Sweet & Maxwell, London 2007) 3.

⁸ *Barry Bramhill, Maureen Bramhill v Mark Edwards, Jane Edwards* [2004] EWCA Civ 403.

⁹ *Ibid*, 39.

¹⁰ *Niblett v Confectionery Materials Co* [1921] 3 KB 387, [1921] All ER Rep 459, para 395.

¹¹ The term satisfactory quality replaced merchantable quality. J. Macleod, *Consumer Sales Law* (2nd edn, Routledge, London 2007) 512.

¹² *Clegg v Olle Andersson* [2003] 1 All ER (Comm) 721, para 48.

the submissions of counsel for Mr Andersson. The suggestion that the effect of the overweight keel is absorbed into the margin of safety built in to the rig by the manufacturers is contrary to the evidence of Mr Saunders (paragraph 37 above) and the fact that the manufacturers found the increased load to be unacceptable, as recorded in paragraph 4 of the agreed statement of the experts. Nor is the cost of remedial works any reliable indication of whether the defect which requires to be remedied prevented the Yacht as delivered from being of satisfactory quality.¹³

Highlighting the importance of protection provided by section 14, the Court went on to say:

There is an implied term, in English Law a condition, that goods sold in the course of a business must be of satisfactory quality: s 14(2) and (6). There are no implied terms as to quality in a sale of goods contract other than those implied by sections 14(2) and (3) and 15 of the Sale of Goods Act 1979 (and any other enactment). This means that in the great majority of consumer sales the buyer has to rely upon section 14. If he does not have a remedy under section 14 he has no remedy at all. It so happens that the goods in this case did not comply with the express term of the contract that they will be in accordance with the manufacturer's specification. But if there had been no such term, it would have been a surprising result indeed if the buyer had no legal remedy for a state of affairs which the seller himself considered unacceptable.¹⁴

Section 14 therefore protects the interests of buyers in having satisfactory quality goods that comply with any description, price (if relevant).

3.2 Substandard Goods: The Primary Objective of Section 14

Section 14 (2) is aimed to assure consumers that all saleable products maintain a minimum standard of satisfactory quality. As such, it does not provide any guarantee of extra quality neither it does make it legitimate, as a general rule, to introduce factors peculiar to the purposes of a particular buyer.¹⁵ In *Balmoral Group Ltd v Borealis (UK) Ltd*, the Queen's Bench Division (Commercial Court) examined the objective of section 14 (2). The Court observed that:

Section 14(2) of the Sale of Goods Act 1979 is *primarily* directed towards substandard goods. Although there is an overlap between section 14(2) and (3) the function of 14(2) is to establish a general standard which the goods in question are required to reach, and not to ensure that they attain some higher standard of fitness for a particular purpose made known to the seller. In

¹³ Ibid, 47.

¹⁴ Ibid, 71.

¹⁵ *Jewson Ltd. v. Kelly* (n 1); Benjamin (n 1).

appropriate cases the question as to whether goods are of satisfactory quality may be determined by considering whether they are fit for all purposes for which goods of the kind in question are commonly supplied section 14(2 B) (a).¹⁶ (Emphasis added)

Section 14 (2) therefore establishes only a *general* quality standard. Under this standard, examining whether a product is of satisfactory quality requires assessing whether the product simply meets a certain level of quality and is fit for all purposes for which goods of the kind in question are commonly supplied.

The term satisfactory quality is thought to be more favourable to consumers than ‘merchantable quality’.¹⁷ The interpretation of that concept however has proven to be easier said than done. It requires many facts to be balanced against each other. Even after considering all related factors, the result of the test may vary significantly. The gap between goods which are of a quite good quality standard, as an example, is different from those which have just made the grade.¹⁸ This is a crucial issue given the fact that section 14 (2) targets mainly substandard goods, and thus provides *only* a minimum quality standard for all saleable products. As such, the test of satisfactory quality does not reflect the variety of quality between satisfactory products, and therefore the potential gain or loss a consumer may endure by buying one satisfactory quality product over another. That is why some argue that that test is not good enough and, therefore, goods have to be of ‘good’ or ‘sound quality’ rather than of ‘satisfactory quality’. The former terms are thought to be more demanding and better for consumers than the latter.¹⁹

3.3 Satisfactory Quality: What is the Test?

When considering the quality of a product, many factors have to be taken into account including its description. The product must always comply with its description. This description affects the standard of quality that can be expected. Other factors, such as price, durability, can only be considered if relevant.²⁰

¹⁶ *Balmoral Group Ltd v Borealis (UK) Ltd & Ors* (n 1).

¹⁷ G Howells, and S Weatherill, *Consumer Protection Law* (2nd edn, Ashgate Publishing Limited, Hants 2005)168- 173.

¹⁸ *Ibid*, 171.

¹⁹ *Id*.

²⁰ *Ibid*, 174.

The rigidity of the quality test in the case of a brand new product, therefore, may not be the same in case of a second-hand one. In both cases, however, the products must be of satisfactory quality. Hence, when goods are used before (second-hand), the consumer would be expected to put up with some defects which would not be satisfactory if found in new goods.²¹

3.4 The Interaction between Price and Quality

Price may not always be connected to an obligation as to quality. This is particularly true where the price is reduced to increase or to speed up sales.²² It is also submitted that where the price has not been fixed by the seller, such as at an auction where the price is usually determined by the ‘weakness of the weaker of the two bidders’, the connection between price and quality might not be relevant.²³

In other scenarios, however, charging a high price can be interpreted as sending a signal as to the quality of goods in question. In other words, charging a high price conjures up a particular set of expectations which exceed the level of satisfactory or ordinary quality.²⁴ In *Rogers v. Parish (Scarborough) Ltd*,²⁵ the Court of Appeal observed that price might have a clear impact in raising a consumer’s expectation as to the quality of a product. The Court pointed out the instance of the sale a Range Rover:

The factor of price was also significant. At more than £14,000 this vehicle was, if not at the top end of the scale, well above the level of the ordinary family saloon, the buyer was entitled to value for his money.

In *Clegg v. Andersson*, the Court of Appeal took an opportunity to uphold that view stating that the purchaser of an expensive brand new ocean-going yacht is duly entitled to expect his yacht to be in perfect conditions.²⁶ The Court stated:

²¹ Howells and Weatherill (n 17) 174.

²² Ervine (n 6) 689.

²³ *Harvela Investments Ltd v. Royal Trust Company of Canada Ltd* [1985] 3 WLR 276, at 230.

²⁴ This is particularly important in the case of trade marks where, as we have seen in chapter one, where quality is a big concern, consumers usually buy branded goods for premium grades, page 18. For more information see I Png, and D Reltman, ‘Why are some products branded and others not?’ (1995) 38 J L and Economics 221; for general information see B Klein, and K Leffler, ‘The Role of Market Forces in Assuring Contractual Performance’ (1981) 89 J Political Economy 615- 641.

²⁵ *Rogers and Another v Parish (Scarborough) Ltd. and Another* [1987] 2 WLR 353, at 944.

²⁶ *Clegg v Olle Andersson* (n 12) 72.

The test is whether a reasonable person would think the goods satisfactory, taking into account their description, the price (if relevant) and all other relevant circumstances... In some cases, such as a high priced quality product, the customer may be entitled to expect that it is free from even minor defects, in other words perfect or nearly so.²⁷

Hence, consumers who pay a high price would expect to receive products well above the ordinary level of quality.²⁸ The more expensive the product is, the higher a consumer's expectations about its quality. The opposite however is not necessarily true.²⁹ Keeping the relevance of price in mind, in the above both cases the Court of Appeal did not provide any guidance how to differentiate between satisfactory and extra quality goods. This question is yet to be answered.

3.5 Quality and the Question of Fitness for Purpose

Where goods are sold in the course of business, they must be fit for all of the purposes for which goods of that kind in question are commonly supplied.³⁰ This term provides consumers with a greater degree of protection since goods might be reasonably priced; correspond with their description, and be of satisfactory quality, yet they nevertheless might not fit for the purchaser's purpose.³¹ This term therefore is directly interrelated with the quality test. The purchaser of high-grade mahogany would rightly expect his wood to be suitable to make furniture. If the wood was not good enough to be used to make furniture, the product would not be of a satisfactory quality.³²

The courts are likely to implement a comprehensive approach when establishing the test of fitness for purpose. In *Rogers v. Parish (Scarborough) Ltd*,³³ the Court of Appeal upheld this view by stating:

Starting with the purpose for which goods of that kind are commonly bought, one would include in respect of any passenger vehicle not merely that buyer's purpose of driving the car from one place to another but of doing so with the

²⁷ Ibid.

²⁸ Howells and Weatherill (n 17) 176.

²⁹ This test however does not apply to services. See M Gabbott, and G Hogg, *Consumers and Services* (John Willey and Sons, Chichester 1998) 109.

³⁰ Section 14 (2b).

³¹ Atiyah, MacQueen, and Adams (n 6) 143; Ervine (n 6) 691.

³² Howells and Weatherill (n 17) 174.

³³ *Rogers and Another v Parish (Scarborough) Ltd. and Another* (n 25).

appropriate degree of comfort, ease of handling and reliability and, one might add, of pride in the vehicles' outward and interior appearance.

Further, the fitness for purpose condition provides consumers with some protection where they have particular demands of the goods which they make known to the seller and they rely on the seller's skills to ensure that the products reach those qualities.³⁴

In order for a product to be fit for its purpose and, therefore, to be of satisfactory quality, it should last for a reasonable time. That is why the issues of durability are usually raised in the context of fitness for purpose.³⁵ It is important to recognise that the time of assessing satisfactory quality is when goods are supplied. This is also the case in terms of assessing the durability of the product in question. This is despite the fact that consumers cannot evaluate the durability of the purchased product at this early stage of purchasing. Nevertheless, the involved parties can change the date of assessing quality.³⁶

In *Jewson Ltd. v. Kelly*, the Court of Appeal clarified the relationship between satisfactory quality and fitness for a particular purpose.³⁷ The facts in this case were interesting. Mr. Kelly was converting a building into 13 self-contained flats for sale. Since it was too expensive to extend the gas supply to each of the flats, he decided to install electrical boilers. Kelly approached his local branch of Jewson seeking advice. The latter recommended a particular type of electrical boiler which was claimed to provide a cost-effective heating alternative to gas-powered boilers which comply with all relevant regulations. Mr. Kelly bought 12 boilers from Jewson and had them installed in the flats and they appeared to work well. However, after the installation of the boilers, the Standard Assessment Procedure to establish the energy efficiency of residential dwellings (SAP) rated the flats very low. This made the flats less attractive to prospective purchasers. Mr. Kelly sued Jewson claiming that the boilers were neither of satisfactory quality nor fit for his purpose.³⁸ The Court of Appeal found that neither Kelly nor Jewson knew of these ratings and it was not until Kelly

³⁴ Howells and Weatherill (n 17) 177.

³⁵ *Ibid*, 179.

³⁶ Macleod (n 6) 501; M Bridge, *The Sale of Goods* (OUP, Oxford 2003) 311; M Bridge, *The Sale of Goods* (2nd edn, OUP, Oxford 2009) 397.

³⁷ *Jewson v. Kelly* (n 1).

³⁸ Ervine (n 6) 684- 703.

applied for planning permission when he first learnt that he would have to obtain such a rating. Thus the Court concluded that a ‘buyer’s reliance under section 14 (3) does not have to extend to all aspects of the goods’ fitness for the buyer’s particular purpose, and that reliance may be partial only’.³⁹

The Court of Appeal emphasized that section 14 (2) is directed *principally* to the sale of ‘substandard goods’. This, in turn, means that the ‘court’s principal concern is to look at their intrinsic quality, using the test indicated in subsection (2A), (2B) and (2C)’.⁴⁰ Therefore, Kelly had made a particular purpose to Jewson and had relied on them to supply a product which met that purpose.⁴¹ Moreover, the SAP poor rating does not render the boilers unsatisfactory in quality and this element was not a relevant factor in applying the quality test since the boilers performed as a reasonable person would expect.⁴² Sedley pointed out that section 14 (2) establishes a *general* quality standard, whereas section 14 (3) imposes ‘a particular obligation tailored to the particular circumstances of the case’.⁴³ Examining whether a product is of a satisfactory quality requires assessing whether the product meets the ‘standard a reasonable person would regard as satisfactory, taking account of any decryption of the goods, the price (if relevant) and all the other relevant circumstances’.⁴⁴ This test is flexible and its result may vary from case to case depending of the relevant circumstances. Yet, ‘factors peculiar to the purposes of a particular buyer’ would not be relevant for the purpose of section 14 (2).⁴⁵ Thus, section 14 (2) deals with the ‘intrinsic’ qualities of the goods. By contrast, section 14 (3) extends to ‘extrinsic’ factors providing that these are made known clearly to the seller.⁴⁶

3.6 Appearance, Finish and Freedom from Minor Defects

Appearance, finish and freedom from minor defects are all related to the quality test. The presence of these factors, however, does not necessarily render products

³⁹ *Jewson v. Kelly* (n 1) 68.

⁴⁰ *Ibid*, 77.

⁴¹ *Ibid*, 78- 80; for more information about this point see C Flesner, ‘The relationship between satisfactory quality and fitness for purpose’ (2004) 63 Cambridge LJ 22- 24.

⁴² *Jewson v. Kelly* (n 1) 78- 80.

⁴³ *Ibid*, 47.

⁴⁴ *Ibid*, 77.

⁴⁵ *Ibid*, 69.

⁴⁶ *Ibid*, 47.

unsatisfactory as those facts are only to be considered as part of an overall quality assessment test.⁴⁷ Therefore, minor blemishes or defects in some new products, such as pottery or earthenware, does not necessarily mean that the products in question are not of a satisfactory quality. The purchasers of such products should expect some inconsistencies. The lack of uniformity in that case can be justified.⁴⁸

4. The Quality Guarantee versus Section 14: The Rationale of Quality Regulation

There appears to be a clear difference between the role of the quality function under trade mark law in comparison with that under section 14. Under trade mark law, the role of this function is to inform consumers about the different specifications of a range of similar or identical satisfactory quality goods.⁴⁹ By contrast, the role of the satisfactory quality test under section 14 is mainly to differentiate between satisfactory and unsatisfactory quality products.⁵⁰ Thus, unlike the quality function, this test is not *mainly intended* to reduce consumer searching costs nor it is primarily intended to enhance the production of high quality goods. Rather, it is designed to prevent faulty products from entering the market and, if they do, to secure the rights of consumers for compensation.⁵¹ That is why the law provides a minimum measurable quality test.

It is difficult to pin down, with a good level of certainty, the rationale or rationales of the test of satisfactory quality within the section 14 framework. One of the most consistent arguments is that regulating quality is mainly intended to protect the health and safety of consumers and it would be difficult to justify quality regulation for any other reason.⁵² Another argument can be put forward is that section 14 enhances the production of quality goods thus deriving economic efficiency.⁵³ This argument however is limited by the fact that section 14 imposes one basic test of quality which, by any standard, does not reflect the level of quality diversity available in the market.

⁴⁷ Howells and Weatherill (n 17) 178.

⁴⁸ *Millars of Falkirk Limited v Turpie* [1976] SLT 66, at 68- 69.

⁴⁹ Chapter one, 8- 17; chapter two, 9.

⁵⁰ *Balmoral Group Ltd v Borealis (UK) Ltd & Ors* (n 1); *Jewson Ltd. v. Kelly* (n 1); Benjamin (n 1).

⁵¹ See in general Howells and Weatherill (n 17) 147- 157.

⁵² *Ibid*, 145.

⁵³ *Ibid*, 147.

Keeping this in mind, it is obvious that this regulatory body (section 14 (2)) is not as sophisticated as one might hope.

A possible solution for tackling the deficiency of the satisfactory quality test could be to create more diverse standards of quality measurement. So, why does consumer law not enforce more diverse tests of quality? The problem with this approach is that it is partially impossible to standardize quality in the first place. There is no way to tangibly determine whether a product is of satisfactory or extra quality standard. Despite the fact that quality issues are easily recognizable, they are neither simply describable nor measurable. For this reason, apart from the case where the public might be at risk, consumer law does not enforce specific quality standards.⁵⁴ This raises the question: why it is very difficult to measure, and thus standardise, quality?

4.1 How to Measure Satisfactory from Extra Quality Goods?

Considering the importance of differentiating satisfactory from high quality goods, an urgent question emerges: how can one measure or differentiate between satisfactory and excellent quality products? Enforcing multiple quality standards is neither desirable nor legally workable.⁵⁵ Given the number of products available in the market, it would be impossible to set a satisfactory and extra quality standard for every product. It is difficult to figure out the criteria for establishing the standards. Who should set these criteria, consumers or traders, and why? After all, the conditions required for producing a good quality computer are not the same for producing a good quality wine. The same applies to software, cars, clothes and medicines. The deficiency of standards to reflect the potential variety of consumer criteria or interests was clearly outlined by the Molony Committee's report. The report states:

Satisfactory overall quality may be an amalgam of a dozen or more different characteristics... Significant questions have to be put in respect of each; they may not emerge in definitive form until the drafting has been put in hand, and it may be impossible to ensure some of them without further research.

⁵⁴ Ibid, 145.

⁵⁵ Generally speaking, standards are used to increase product safety in measurable and enforceable way. They are defined as a 'classical method for regulating industry's behaviour'; S Breyer, *Regulation and its Reform* (Mass Harvard University Press, Cambridge 1982) 96. Cartwright defines standards as 'minimum duties imposed upon traders, and may be enforced through the criminal or civil law'; P Cartwright, *Consumer Protection and the Criminal Law: Law, Theory, and Policy in the UK* (CUP, Cambridge 2001) 44.

Moreover, there is rarely likely to be an absolute answer to any one of these inquires; the quality and durability that can be provided are closely related to the price which the buyer is likely to be willing and able to pay, so that at each point the answer must be -a compromise which is not only a nice exercise in judgment it itself, but must be married with compromise arrived at on every other point.⁵⁶

The difficulty to reflect the potential variety of consumer tests of quality is by no means the only problem for establishing a more demanding standard regime. Another much more complicated issue is how to enforce a quality standard in the first place.

[W]henever we have investigated in detail we have unearthed no foundation for supposing that more or better standards could be devised to provide worthwhile guarantees of overall quality respecting consumer goods. We concede that in some few cases it may be possible to devise further standards which would be used to give greater assurance about certain characteristics of particular lines of goods, assurance of sufficient value to make the production and use of those standards of genuine benefit to the consumer. But the scope of such development, and the benefits to be derived, are, in our judgment, limited.⁵⁷

Obviously, it is difficult to pin down the exact meaning of quality. For this reason, standards are mainly used to ensure product safety.

4.2 Could the Enforcement of the Quality Function be the Answer?

One of the reflections of the preceding argument is that there is a recognizable gap between products of satisfactory quality and those of excellent quality, the latter being regulated under neither consumer law nor trade mark law. Enforcing the quality guarantee under trade mark law therefore could be a plausible solution.

The role of the quality guarantee under trade mark law is much more comprehensive and goes much further than the test of satisfactory quality. As such, the notion that

⁵⁶ Board of Trade, Final Report of the Committee on Consumer Protection. Cmnd 1781 1 962, para 254.

⁵⁷ Ibid, 256; Whenever the required conditions for the production of a given product are set however, it is relatively easy to enforce the standard upon the traders who produce that particular product; Cartwright (n 55) 46. The advantage however is that such a standard might discourage market and social innovation; R Stewart, 'Regulation, Innovation and Administrative Law: A Conceptual Framework' (1981) 69 California L Rev 1261. That is why the United States, for instance, prohibits the use of specification standards in safety regulations and prefers instead performance standards; G Howells, *Consumer Product Safety* (Ashgate Publishing Limited, Dartmouth 1998) 208. Apart from the food industry, the EU's policy seems leaning towards the same direction; A Oigus, *Regulation: Legal Form and Economic Theory* (Clarendon Press, Oxford 1994) Ch. 4.

branded goods are of satisfactory quality is usually assumed. When a trader brands a product, he is saying to consumers that his product is different from those of his competitors regardless of whether this statement is genuine or not.⁵⁸ If the use of the mark is intended to send consumers a signal that the quality of all branded products, more or less, of satisfactory quality, it would be difficult to justify the act of branding goods in the first place. Consumers use trade marks therefore to differentiate the quality of identical or similar quality products rather than to differentiate between substandard and satisfactory quality goods. In other words, the role of the quality function under trade mark law starts where it ends under section 14. The test of satisfactory quality helps consumers to differentiate between satisfactory and substandard goods. By contrast, the quality guarantee helps consumers to identify differences in quality between satisfactory quality goods. According to this interpretation, the scope of the quality guarantee under trade mark law is different and much wider than that under section 14 and thereby can be utilized to highlight quality differences between satisfactory goods.

Trade marks thrive in a market where goods and services are not of a uniform quality and where consumers dignify this fact by using the reputation of the mark as a sign of quality.⁵⁹ This is pretty much the essence of branding goods. Under this concept, the role of the quality guarantee is not to inform consumers that all products are of satisfactory quality. Rather, it is about presenting and informing consumers about the variation between the qualities of branded goods, which are assumed to be safe and fit for purpose. Satisfying the minimum quality standards therefore might not be an issue for the trader of branded goods. Exceeding the minimum level of quality is what trade mark use is all about. That is why traders use marks to differentiate the quality and excellence of their products from those of their competitors. This process is thought to enhance competition.⁶⁰ For this reason the role of signs, badge of origin and quality, is protected in the first place.⁶¹ Had all producers maintained a uniform satisfactory level of quality, trade marks would have been made redundant because consumers would not have needed to use them in the first place because they would

⁵⁸ Chapter one, 14, 20- 22.

⁵⁹ Chapter two, 14.

⁶⁰ Chapter one, 20- 22.

⁶¹ Ibid, 14.

know that all goods hold, more or less, the same level of quality. This, however, could not be further from the truth.

In other words, the concept of quality under trade mark law does not imply any sort of quality uniformity. On the contrary, the law encourages traders to provide varied levels of quality products and, in return, the law rewards them by effectively protecting their marks according to the level of fame they have acquired.⁶² The stronger the reputation of the mark the more protection it gets and *visa versa*.⁶³ In the case of reputable marks, even the aura of luxury emanating from luxury goods is protected. This is because, according to the ECJ, this aura is essential in that it enables consumers to distinguish between *similar* goods.⁶⁴ That is to say the concept of quality under trade mark law conveys, to a great extent, a different message from that under section 14.

Based on the above, and counter to mainstream thinking, it seems that trade mark law is better placed to dealing with quality issues than section 14 of the SGA of 1979.

4.2.1 Things to Consider before Enforcing the Quality Function under Trade Mark Law

The task of establishing an enforceable quality mechanism that takes into account quality diversity between satisfactory goods is easier said than done. It is still possible however to provide a few recommendations as to what any possible solution should take into account. Firstly, the test of satisfactory quality underpins section 14 has a limited impact in deriving economic efficiency and thus the production of quality goods. As such, it does not properly protect the interests of consumers as discussed before.⁶⁵ There should be other mechanisms that recognise and regulate differences between satisfactory quality goods. Secondly, and closely related to the former point, any attempt to do so should not involve standardising quality production, thus enforcing traders to maintain a particular level of quality.⁶⁶ It is not

⁶² Ibid, 15- 17.

⁶³ Chapter three, 100, 106- 113.

⁶⁴ Case C- 59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40, paras 24- 26; see chapter three, 23.

⁶⁵ Trade mark protection is said to enhance competition and thus the production of quality goods and reduces consumer searching costs. chapter one, 15- 17.

⁶⁶ For more information about the implications of enforcing quality standards on social welfare see

possible to create measurable and thus enforceable standards that reflect quality diversity between satisfactory goods. There are simply too many subjective factors that have to be taken into account.

Thirdly, developing a new mechanism for highlighting quality differences between satisfactory goods should not necessarily mean enforcing new rules or changing the law. Even after establishing the limitations of market forces (the deregulation approach adhered to by the Chicago School)⁶⁷ and the deficiency of the test of satisfactory quality under section 14, there are still a few important questions which have to be raised. For example, who will benefit and who will pay? Is there any less costly way to solve the problem?⁶⁸ Thus, a legal intervention in the market to enforce the quality function cannot be conducted before paying regard to ‘the motivation behind the trader’s activity in the market- is there a genuinely satisfied client base or is the trader specifically exploiting a loophole in the law or enforcement’. As such, it is arguable that we should favour solutions that:

...once introduced, can be sustained by the market over those require ongoing intervention. The least invasive initiatives are likely to be those improving information flows, although these will not always be sufficient. Regulation would be a last resort, only to be used if other approaches cannot succeed.⁶⁹

In other words, preferably, any suggestion to enforce the quality function under trade mark law that, once introduced, can be sustained by the market and does not impose extra costs.

Having investigated the concept of satisfactory quality under section 14 of the Sale of Goods Act, we now turn our attention to the concluding, and final, part of this thesis.

N Bockstael, ‘The Welfare Implications of Minimum Quality Standards’ (1984) 66 *American J Agricultural Economics* 466.

⁶⁷ Chapter four, 159.

⁶⁸ M Pertschuk, *Revolt Against Regulation*, 139 cited in I Ramsay, *Consumer Law and Policy: Text and Materials on Regulating Consumer Markets* (Hart Publishing, Oxford and Portland, Oregon 2007) 55.

⁶⁹ Department of Trade and Industry, *Extending Competitive Markets: Empowered Consumers, Successful Business* (2005) <<http://www.berr.gov.uk/files/file23787.pdf>> accessed 17 February 2009.

Chapter Six: Conclusions

For consumers and traders alike, trade marks are indispensable commercial tools.¹ By fostering competition and reducing search costs, trade marks are regarded as crucial contributors to the interests of consumers and to the process of competition. These benefits however are only guaranteed where the traders of branded goods maintain consistent quality.² In the case of doing otherwise, the protection of marks could enhance artificial product differentiation and thus distort competition and increase rather than decrease consumer searching costs.³ The failure to enforce the quality guarantee, therefore, could have far reaching results, the most troubling of which are linked to a broad conception of enhancing the artificial components of a product, and thereby building a trade mark's selling power or reputation based on a brand rather than on the quality of the product to which the mark is attached. In such a case, traders could actively shape consumer purchasing behaviour. In turn, this will allow traders an excessive monopoly. That is why protection on the basis of a trade mark's selling power or reputation should never be separated from the product to which the mark is affixed.⁴ If the benefits of trade mark protection are to be ensured, the protection afforded to the intangible attributes of a trade mark should always be balanced against the true value of the product to which the mark is attached.⁵ Otherwise, trade mark protection excessively expands the monopoly power of the trade mark owner and thus distorts competition.⁶ It is against this backdrop that this thesis investigated and concluded that the quality function should be independently recognised and enforced under trade mark law.

1. Quality Function Enforcement under Article 5(1) of Directive 2008/95

Examining the visibility of the origin-oriented model of trade mark protection underpins Article 5 (1) of Directive 2008/95 to achieve the objectives of trade mark

¹ Chapter one, 14, 20- 22.

² Ibid, 28- 33.

³ Ibid.

⁴ Id.

⁵ Id.

⁶ Id.

protection, namely promoting competition and reducing consumer searching costs, without the need to enforce the quality guarantee of the mark, revealed interesting results. Perceived as an economic function that trade mark law is not equipped to deal with, the quality guarantee is not sufficiently protected under Article 5(1).⁷ Taking the economic and legal objectives of trade mark protection into account however, the Court of Justice (the Court) enforcement of this function is neither sustainable nor consistent. As discussed in chapter two, the essence of restricting trade mark protection to its core function is to prevent the use of trade mark rights to artificially partition of markets and price maintenance in the Union.⁸ It is for this reason that the Court has repeatedly emphasised that an important aspect of the origin function is to enable the owner of the mark full control over the quality of the products for which he should be held accountable.⁹ The question of how one might effectively reconcile tensions between trade mark protection and free movement of goods therefore rests on the proper interpretation of the trade mark subject-matter and, more specifically on the essential function of the mark. Once again, from legal and economic standpoints, the rationale of identifying the trade mark subject-matter is mainly intended to prevent the use of trade mark rights to artificially partition the markets between Member States and to reward the manufacturer who consistently produces high quality goods and thus stimulate economic progress.¹⁰

Thus, by *not* enforcing the quality guarantee under the trade mark subject-matter doctrine, the Court of Justice has failed to put the essential function of the mark into its wider legal and economic contexts. As concluded in chapter one, quality inconsistency damages competition and increases consumer search costs regardless of whether the failure to do so (maintain quality) is due to the trade mark owner's fault or to a third party.¹¹ In both cases, trade mark protection could enhance artificial partitioning of markets and price maintenance, and hence distort competition. According to this interpretation, the failure to maintain the quality of goods is likely to distort competition even when the essential function of the mark is established. It is difficult to justify the costs of not maintaining quality imposed on consumers under

⁷ Chapter two, 61.

⁸ *Ibid*, 54- 58.

⁹ *Ibid*, 64- 66.

¹⁰ *Id*.

¹¹ See (n 1) 28- 33.

trade mark law considering the fact that one of the main reasons for protecting marks in the first place is to reduce consumer search costs. The notion of not enforcing the quality guarantee therefore does not fit easily with the legal and economic rationale of trade mark protection as it is pictured, i.e. a way of promoting competition and thus the production of quality products and the reduction of consumer searching costs.¹²

In the field of international exhaustion, the Court enforcement of the quality guarantee revealed a great deal of legal inconsistency. According to the Court of Justice, trade mark protection enhances artificial partitioning of markets and price maintenance if it does not contribute to the establishment of the trade mark core function, a badge of origin.¹³ As such, it is legally difficult to justify the prevention of importing genuine goods into the Union. The act of preventing parallel importation from outside the Community even where the essential function of the mark is not impaired provides traders with a great deal of legal protection against competition from foreign markets. This protection however might have the equivalent effect of enhancing artificial price maintenance and artificial partitioning of the Community markets from international markets. In this arena, the law is clearly biased towards traders.

As we concluded in chapter two, the Court should adequately emphasise the link between the quality and origin function within the boundaries of a trade mark subject-matter doctrine. As such, it should recognise a more complicated framework of interconnected relations between the origin and the quality which reflects the independent nature of the guarantee function. To this end, the Court of Justice is advised to explicitly recognise the quality function of the trade mark when shaping the scope of trade mark protection. This recognition should lead to the enforcement of that function not only against parallel importers but also against the trade mark owners themselves.

2. Quality Function Enforcement under Article 5(2) of Directive 2008/95

¹² Ibid, 20- 22.

¹³ See (n 7) 68; Joined Cases C- 427, 429 & 436/93 *Bristol-Myers Squibb and Others v Paranova* [1996] ETMR 1, para 49.

The enforcement of the quality guarantee under the dilution doctrine (Article 5(2)) is even more controversial. The European trade mark law appears to be granting reputable marks too much protection, and thus excessive monopoly, in return for too little. From *Canon*¹⁴ to *Dior* 2009,¹⁵ the law has moved gradually towards expanding the scope and level of trade mark protection. This tendency is paralleled by another much more troubling attitude towards downgrading the importance of the quality function of the mark. Taking the legal and economic rationale of trade mark protection, economic efficiency rather than trade mark efficiency *must* be the criteria against which the level and scope of protection should be measured. The need to take the question of quality seriously under the dilution doctrine is not limited to whether or not to enforce the quality function by law. Rather, it goes to the heart of policies underpinning trade mark protection in the first place and whether the law should simply react to how traders brand or present their branded goods or whether instead the law should seek to actively influence a trader's commercial behaviour.

As chapter three concluded, the notion of considering the uniqueness of a trade mark as 'the only rational basis for its protection', and thus expanding protection of the reputable mark to non-trade mark subject-matters, such as its selling power or reputation, is not always tenable. The trouble with Schechter's concept of trade mark protection is that it rests on unverified assumptions about how marks work, and, because of its assumptions, it might be granting marks with a reputation too great a monopoly in return for too little. The dilution doctrine downplays the significance of confusion as a ground for trade mark liability and focuses on the need for the protection of the interests of a trade mark owner.¹⁶ The main goal is the protection of the selling power of the mark. That is why protecting the interests of consumers as to quality issues is not a priority. However, considering the Court of Justice case-law and the rationale for trade mark protection, it is clear that the law protects the relationship between a mark with a reputation and a particular product, particularly the way consumers perceive that reputation in the context of that relationship: a sign

¹⁴ Case C- 39/97 *Canon Kabushiki Kaisha v Metro-Goldwyn-Mayer Inc.* [1999] 1 CMLR 77, paras 22-24.

¹⁵ Case C- 59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40, paras 24- 26; see also *L'Oréal v Bellure* (n 2) para 44; Case C- 252/07 *Intel Corp Inc v CPM United Kingdom Ltd* [2009] ETMR 13, para 67.

¹⁶ Chapter three, 95.

of quality.¹⁷ For this reason, the fact that dilution is mainly about protecting the investment of the trade mark owner should not make the question of quality redundant.

The Court of Justice however appears to agree with Schechter's notion of protection, thus adhering to the argument that protecting the distinctiveness of the mark should be the only rational basis for protection. In *Copad v Christian Dior*, for instance, the ECJ found that the quality of luxury goods results not just from their physical characteristics but also from their allure and prestigious image which confer on them an aura of luxury. This aura of luxury emanating from luxury goods is essential in that it enables consumers to distinguish them from similar goods. Hence, any impairment to that aura of luxury is likely to affect the actual quality of those goods.¹⁸

Keeping the traditional grounds of trade mark protection in mind, this expansion of protection seems difficult to defend. The Court of Justice has failed to provide adequate explanation in relation to what 'quality' means. This is an extremely important point. There is a tradeoff between the costs and benefits of expanding the protection of a reputable mark. As such, any expansion to the protection of the intangible aspects of the trade mark must contribute to the objectives of protection. The problem, however, is that by considering the presentation of goods and their allure and prestigious image as protectable subject-matters, the Court of Justice might be unwittingly encouraging artificial product differentiation. Presentation, allure and the prestigious image of goods (brand values) add very little to the product. However, they severely influence consumer purchasing decisions.¹⁹ Bearing this in mind, the Court ruling could encourage traders to build a reputation on the brand rather than on the product to which it is affixed. In this case, even if the prestigious image of the branded good constitutes its distinctive character or reputation, the protection of such economically artificial components does not necessarily enhance the consumers' rational commercial behaviour.²⁰ In the long run, the Court ruling in *Dior* might increase the risk of simply improving the advertising value of branded goods at the

¹⁷ See (n 7) 64- 66; 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.

¹⁸ See (n 16) 177; Case C-59/08 *Copad SA v Christian Dior Couture SA* [2009] ETMR 40, paras 24-26.

¹⁹ *Ibid*, 129- 142.

²⁰ See (n 1), 28- 33.

expense of their quality which is contrary to the legal and economic rationales of trade mark protection as explained in chapter one. The risk becomes very clear in the case where the quality of the product sold under the mark is not different from what is already available in the market.²¹ In this case, it is much easier for traders to compete by improving the persuasive value of their marks rather than following the more expensive path, and thus improving the quality of goods to which the marks are attached.

The trend towards granting marks with a reputation more protection is not combined with a clear view as to how exactly the protection of brand values contributes to the legal and economic objectives of the law. Given the impact of a trade mark reputation on retaining the loyalty of consumers (and thus expanding the monopoly power of a trade mark owner), tackling that issue becomes a must. If built on the brand itself rather than on the product to which it is attached, the selling power of the mark or its reputation can be formidable anti-competitive weapon. In this case, the mark's appeal to consumers is independent of the quality or the price of the product in question. In turn, as discussed in chapter one,²² this means that the owner of the mark enjoys an excessive level of trade mark monopoly.

Thus, Schechter's argument that the preservation of the uniqueness of a trade mark should constitute the only rational basis for its protection is not sustainable where such uniqueness does not contribute to the legal and economic objectives of protection. This can only be achieved if the selling power of the mark or its reputation is linked in some shape or form to the specifications of a product and not built on a vacuum.

3. Why should we be Concerned?

Inevitably, our argument that the quality guarantee is not sufficiently protected under Article 5(1) and (2) remains incomplete. It ignores very important question: why the quality function is not properly protected? Is there market failure or traders are simply exploiting a loophole in the law or enforcement?

²¹ See (n 16) 129- 142; chapter four, 162- 168.

²² See (n 1) 28- 33.

The lack of need for the enforcement of the quality guarantee of a trade mark is based on two major assumptions. The first is the effectiveness of market forces, or what the Chicago School termed a self-enforcing feature of a trade mark, in encouraging traders to maintain the quality of their goods. The second is the availability of a substantial body of laws which are intended mainly to protect the interests of consumers in having quality products on the other.

4. The Deficiency of the Chicago Deregulation Approach

As explained in chapter four, the Chicago Economic School argues that traders are unable to lower the quality of their branded goods or otherwise try to deceive consumers, because when they catch on, the producer may lose his entire investment.²³ Hence, market forces are sufficient to protect the interest of consumers as to the quality issue. According to this ‘deregulation’ approach, there is no need to enforce the quality function within the framework of trade mark law.

As this thesis has shown however, the Chicago approach to law and economics is based on one particular controversial approach to economics. The Chicago model of quality enforcement is based on three questionable assumptions: perfect competition, individual rationality and wealth maximisation. The Chicago economists seem to overstate the role of market forces, and by doing so minimise the need for legal intervention to enforce the quality function under trade mark law.

Firstly and as explained in chapter four, it is widely acknowledged that a system of perfect competition is unlikely to be observed in practice. Scholars of competition law adhere instead to the idea of workable competition.²⁴ As such, markets may not work well in supplying consumers with product information, as assumed by the Chicago economists. Secondly, unlike companies where it is possible to identify successful (rational) from unsuccessful (bankrupted) commercial entities, there is no criterion against which the concept of individual rationality can be measured. That is why, under the Chicago approach, this concept (individual rationality) is assumed but

²³ Chapter four, 159.

²⁴ Ibid, 160.

not explained.²⁵ Furthermore, given the advertising and persuasive impact of brands on consumer commercial behaviour, the rational-choice based approach used by the Chicago School does not adequately explain human behaviour. The Chicago law and economics ignores the role of forces such as social norms on individual purchasing decision.²⁶ The inclusion of these norms into the trade mark-consumer relationship makes for robust explanations of consumer behaviour and more accurate predictions of the effects of legal protection.²⁷

Thirdly, the notion that traders always seek to maximise their long term material wealth and this incentive to maintain their own interests, by itself, will encourage them not to reduce the quality of their goods, is not always accurate. As this thesis demonstrated in detail, the elements that influence a trader's decision to maintain the quality of his goods are not easily predictable or certain.²⁸ What is certain however is that the trader perceives the maintenance of quality as a vehicle to retain the loyalty of the consumer *only* as long as there is no other more profitable ways of doing so.²⁹ Toyota's latest crisis proves that while trade marks may indeed indicate a certain level of quality, they do not necessarily maintain consistency of quality.³⁰

5. Why is Quality Regulation under Consumer Law not an Adequate Answer?

For many, the availability of a substantial body of laws which are intended mainly to protect the interests of consumers in having quality products has made the need to enforce the quality issue within the boundaries of trade mark law redundant. From the outset, it seems perfectly sensible to argue that the implementation of the concept of 'satisfactory quality', for instance, underpins section 14 of the Sale of Goods Act 1979 (as amended) guarantees that all saleable goods or services are of a satisfactory quality and fit for the purpose, and that there is no need therefore to enforce this issue within the framework of trade mark law. This view has been debated.

²⁵ Ibid, 154.

²⁶ Ibid, 165- 167.

²⁷ Ibid, 161.

²⁸ Ibid, 160, 168- 174.

²⁹ See (n 16), 129- 142.

³⁰ See (n 21) 172.

It has been argued that the rationale of quality regulation under trade mark law is different from that under consumer protection law.³¹ Under the former, the main role of the quality guarantee is to differentiate between satisfactory quality goods. By contrast, the major objective of this function under consumer law is to discourage the production of substandard goods.³² That is why consumer law applies a compulsory measurable minimum quality test. Given the fact that the quality of satisfactory goods may vary significantly however, this test does not *adequately* enhance the production of quality goods nor it does reduce consumer searching costs. As such, contrary to mainstream thinking, it seems that trade mark law is better placed to deal with quality issues than section 14.

The enforcement of the quality function under trade mark law however is not straightforward. On the one hand, it is not possible to define quality. As a result, it is not possible to create measurable and thus enforceable standards that reflect quality diversity between satisfactory goods.³³ There are simply too many subjective factors that have to be taken into account. For this reason, the enforcement of the quality function under trade mark law must not involve the standardisation of quality production, thus enforcing traders to maintain a particular level of quality. On the other hand, developing a new mechanism for highlighting quality differences between satisfactory goods under trade mark law should not necessarily involve enforcing new rules or changing the law.³⁴ A very practical solution would be one that, once introduced, can be sustained by the market itself, and thus does not impose extra costs.

6. Forward Thinking

Based on the previous arguments, if trade mark protection is to promote competition and to reduce consumer searching costs, the enforcement of the quality guarantee must be taken seriously. To this end, and in order to tackle this loophole in the law relating to the enforcement of the quality guarantee, a possible solution could be a new interpretation of the trade mark functions under Article 5 (1) and (2) of Directive

³¹ Chapter five, 176, 186.

³² *Ibid*, 180.

³³ *Ibid*, 187, 190.

³⁴ *Ibid*, 190.

2008/95 (and Article 9 (1) of Regulation 207/2009) that pays regard to the fact that neither market forces nor the concept of satisfactory quality are sufficient to protect the interests of consumers as to quality issues. This solution can be explained by way of an example.

Trade marks owners are not required by law to develop a strong reputation. Those who do however are rewarded by granting their marks extra protection. The more reputable the mark the more protection it gets and *vice versa*. The legal impact of having a reputation is very significant. The Court of Justice has repeatedly stated that when determining the protection of a trade mark, account has to be taken of its distinctive character, in particular its reputation. The greater the reputation of the mark, the wider the domain of protection.³⁵ What is more, the more immediately and strongly the mark is brought to mind by the sign, the greater the likelihood that the current or future use of the sign by a third party will be considered to take unfair advantage of the distinctive character or the repute of the mark.³⁶ Developing a strong reputation, therefore, not only increases the scope of protection but also loosens the burden of proof under Article 5(2).³⁷

Keeping that in mind, traders could be encouraged to maintain and improve the quality of their goods if maintaining consistent quality is a precondition for expanding trade mark protection. This solution is about rewarding traders who consistently maintain high quality standards. In line with the protection of reputable marks however, traders who fail to live up to their quality promises should *not* be legally punished under trade mark law. The problem with such a solution is that it advocates the protection of something indefinable. While the quality gap between two satisfactory products might be easily recognizable, the task of describing and hence measuring this gap is quite a delicate matter.

The answer to that question lies in the Chicago law and economics movement. According to Chicago economists, traders are much more informed than consumers.

³⁵ See (n 16) 106, 113; Case C- 39/97 *Canon Kabushiki Kaisha v Metro-Goldwyn-Mayer Inc.* [1999] 1 CMLR 77, paras 22- 24.

³⁶ *Ibid*; C- 487/07 *L'Oréal SA v Bellure NV* [2009] ETMR 55, para 44; Case C- 252/07 *Intel Corp Inc v CPM United Kingdom Ltd* [2009] ETMR 13, para 67.

³⁷ *Ibid*.

They are best placed to identify the specifications of their goods and, to some degree, those of their competitors. If maintaining and improving the quality of goods becomes a part of trade mark protection in general and, expanding the protection for marks with a reputation in particular, traders will have a strong incentive to take quality control more seriously. And if they do not, the quality of their goods will be contested by their competitors which will impact the level of protection their marks may enjoy.

From the outset, there is no reason to believe that contesting the quality of a given product should be much more difficult and thus expensive than establishing that a mark has a reputation. Traders and their competitors are well placed to contest whether the quality of a given product is identical, similar or significantly different from what is already available in the market and without having to define quality in the first place. This is because according to the Chicago School, regardless of a trade mark, traders have full information about the quality of their goods.

Take digital single-lens reflex cameras (DSLR) market as an example. This is one of the most diverse and competitive markets. Satisfactory overall quality of a given DSLR camera may indeed be an amalgam of a dozen of different characteristics such as colour, weight or design. Despite this fact, by analysing its technical performance, it is still possible to establish what makes a good or excellent quality DSLR camera. This can be done without the need to reveal any secret information or know-how. For instance, cameras which have CMOS image sensors (complimentary metal-oxide semiconductor) are faster, sharper and thus capable of producing much better quality photos than those which have CCD sensors (charge-coupled device).³⁸ The CMOS sensor is better and more flexible because, under this technology, each pixel can be read individually.³⁹ Furthermore, optical image stabilization, is better (though more expensive) than digital image stabilization. The former is used to reduce blurring associated with the motion of the camera. This is done by constructing elements within the lens which actually moves to compensate for shaky hands. The latter (digital stabilization) does the same thing but differently. It uses pixels outside the

³⁸<http://www.canon.co.uk/For_Home/Product_Finder/Cameras/Digital_SLR/Technologies_Features/CMOS_Sensor.asp> accessed 12 June 2010;

<http://www.nikon.com/about/technology/core/optical_e/cmos/index.htm> accessed 12 June 2010.

³⁹ Ibid.

border of the visible frame to provide a buffer for the motion, which in turn, reduces distracting vibrations. The down side however is that the more noise-reduction applied, the worse the image will look.⁴⁰

These are mere examples. They show that although it might be difficult to reflect the potential variety of consumer tests of quality, for a trader and because he is fully informed, it is not difficult to understand what makes a good or excellent quality product and, thus to contest the quality of his or his competitor's goods before a court.

Therefore, in the same way legal concepts such as the test of public confusion, identical or similar goods or services, a trade mark reputation, taking unfair advantage of or be detrimental to, have been developed by the Court of Justice, the concept of quality enforcement can also be build up. The previous solution is far from perfect. Still, it provides a practical and thus workable answer to the question of quality. It neither imposes any extra costs on traders nor does it require traders to maintain a certain level of quality. Recently, the Court itself considered the allure and prestigious image of luxury goods as part of their quality but without providing any guidance as what quality means. There is no reason to believe therefore that identifying a standard of quality that traders must maintain should be regarded as a precondition for enforcing the quality function under trade mark law.

The preceding argument leaves us with a few important questions: must traders fight over quality between themselves and in what contest? Put differently, should a challenge to quality operate as a defence? How would this work in practice? Traders and/or their competitors should be permitted to contest the quality of a branded product. After all, traders and/or competitors have full information and thus are well placed to contest the quality of a given product. This 'quality' defence could have a very significant impact, particularly under Article 5(2). This is because, under this Article, the scope of trade mark protection is much wider and more extensive than that under Article 5(1), and thus the risk of using the trade mark's persuasive or

⁴⁰ <<http://www.nikon.com/about/technology/life/stabilization/index.htm>> accessed 12 June 2010; <http://www.canon.co.uk/for_home/product_finder/cameras/ef_lenses/image_stabilization_lenses/index.aspx> accessed 12 June 2010.

advertising power (reputation) to retain the loyalty of consumers, instead of improving the quality of the product to which the mark is attached, can be very high. According to this scenario, the owner of a reputable mark would have to take quality control much more seriously when seeking to establish that the use of its mark, for instance, takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark. This is because, amongst other defences, maintaining and improving the quality of goods become a precondition for expanding the protection of marks with a reputation. A competitor could argue that the quality of the product to which the mark with a reputation is attached is not significantly different from what is already available in the market. Expanding the protection of the mark in this case could in fact enhance artificial product differentiation which, given the role of trade mark reputation in retaining consumers' loyalty, should not be tolerated under trade mark law.

If the previous solution cannot be accepted however, then, we should accept the fact that, while the protection of trade mark secures the investment of the trade mark owner, this does not necessarily promote the production of quality goods nor does it reduce consumer searching costs.⁴¹ Hence, the statement that trade mark protection fosters competition and reduces consumer searching costs must be revisited.

⁴¹ The author would like to thank Dr. Smith for her valuable comments on this particular point.

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