Trademarks, Comparative Advertising, and Product Imitations: An Untold Story of Law and Economics

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Abstract

Comparative advertising is a daily phenomenon in the modern landscape of commercial communication. Interestingly, however, a deep dichotomy exists between the American legal doctrine on comparative advertising and its European counterpart. Whereas American lawyers have cultivated a rather liberal stance, Europe has preserved its historical penchant for prohibiting comparative advertising. This divergence is puzzling when it concerns the handling of so-called imitation claims and product comparison lists, especially with respect to luxury perfumes and smell-alikes, or other exclusive products and their cheaper imitations. European lawmakers, pressured by the French perfume industry, have integrated a *per se* prohibition on imitation claims into the European Directive on Misleading and Comparative Advertising. On the other hand, in the U.S., there is virtually no restriction on imitation claims and comparison lists beyond the prevention of consumer confusion and deception. Indeed, the Lanham Act expressly excludes trademark dilution claims in cases of comparative advertising. To date, however, there has been no comprehensive economic analysis of this panorama. This article seeks to fill that gap. In conducting such an analysis, it reveals severe defects in both the American and European rules on comparative advertising. It also provides the basis for a more specific reconceptualization of the field and helps formulate a theoretical and practical framework for lawmaking and policymaking.

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I. INTRODUCTION

Marketplace communication abounds with comparisons. We are all familiar with iconic battles, such as those between Coca Cola and Pepsi, McDonald's and Burger King, and Verizon and AT&T, in which one side mocks the other's product and features as being boring, lame, or generally inferior.[1] Typically, this mockery is combined with an advantageous presentation of the advertising company's product. Basically, comparative advertising is a popular instrument that newcomers use to enter a market.[2] At the same time, it can enable market leaders to explain to customers why they should go with the "number one."

A more refined scenario of comparative advertising consists of so-called imitation claims and product comparison lists. These cases are structured similarly: The advertising competitor markets, for instance, a no-name perfume that imitates the scent of a luxury original. Producing and offering such an imitation is not illegal since—in most jurisdictions—scents and their formulae are not protected under the patent, copyright, or any other intellectual property regime.[3] Yet simply offering the copy will rarely garner enough consumer attention. Without more information about the two products' correlations, the copy is usually not considered an appropriate alternative to the original. It is thus essential to evoke a mental connection between the substitute and the original. Establishing such a relationship is accomplished by comparing the alternatives. The usual method used in advertising for perfume—a product with a few or only one relevant feature—is a comparison list promoting the cheaper copy over the more expensive original scent. Such lists typically mention both the name of the original brand and that of the alternative smell-alike, and they necessarily also include an accompanying price comparison. "Like Chanel No. 5? Don't want to spend $300? Have the same smell for just $25."

The U.S. and the EU not only regulate comparative advertising differently in general but also specifically differ on whether actors are

1. For examples, see Kaylene C. Williams & Robert A. Page, Jr., *Comparative Advertising as a Competitive Tool*, 7 J. MARKETING DEV. & COMPETITIVENESS 47, 48 (2013).

2. *See id.* at 51.

3. *See* Peter Ruess, Keine Imitationsbehauptung, wenn das beworbene Produkt erst aufgrund weiterer Umstände als Imitat erkennbar wird — „Creation Lamis", 3 GRUR-Prax 499, 499 (2011). For examples from the U.S. and other jurisdictions, see Thomas G. Field, Jr., *Copyright Protection for Perfumes*, 45 IDEA 19, 23–26 (2004); Olivia Su, *Odor in the Courts! Extending Copyright Protection to Perfumes May Not Be So Nonscentsical: An Investigation of the Legal Bulwarks Available for Fine Fragrances Amid Advancing Reverse Engineering Technology*, 23 S. CAL. INTERDISC. L.J. 663, 684–700 (2014).

allowed to state that they offer an identical product. Under Directive 2006/114/EC,[4] the EU sets a strict prohibition on comparative advertising if the advertising entity's product is presented as an "imitation" or "replica" of a trademarked original.[5] Therefore, perfume comparison lists are not allowed. In contrast, under U.S. doctrine, the original producers' trademarks are significantly less protected. Comparative advertising is generally allowed as long as the origin and identity of each product is clear. In this way, comparison lists are usually perceived as legitimate instruments of market communication and commercial speech.[6]

This divergence of results contradicts the common expectation among comparative lawyers of a so-called *praesumptio similitudinis* establishing the idea that practical outcomes in different legal regimes—as different as the regulatory structures and legal cultures may be—are regularly similar, if not identical.[7] This divergence is why a closer look at the economic underpinnings of trademark and unfair competition law is necessary. An economic perspective sheds light on a number of issues that are currently overlooked in legal theory and practice. One widely ignored question has to do with finding an adequate metric for measuring consumer confusion and misrepresentation caused by comparative advertising. How accurately must a comparison inform consumers about the original product's origin, about what features of the imitation product are the same or different, and about what features actually or potentially create the same or different product experiences? In addition, analyzing trademark use in comparative advertising will ultimately have to revert to the virtually eternal question of trademark law: How well protected is an owner's trademark investment? More concretely: Should a trademark owner who has incurred costs to establish trademark goodwill be able to preclude comparative advertising activities that have the potential to weaken the economic value of the investment? In legal terms, the issue

4. Directive 2006/114 of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 21 (EC).

5. *See id.* art. 4(g). Throughout this article, we will use the term "imitation," which is intended to include "replication" or "replica." For an extensive account of European trademark and unfair competition law see Tim W. Dornis & Thomas Wein, *Imitationsbehauptung und Rufausnutzung in vergleichender Werbung- Eine rechtsvergleichend-ökonomische Analyse des Spannungsfeldes zwischen Eigentum und Marktkommunikation*, 8 ZEITSCHRIFT FÜR GEISTIGES EIGENTUM, forthcoming 2016.

6. *See* Lanham (TradeMark) Act of 1946 § 43(c)(3)(A), 15 U.S.C. § 1125 (2016) (excluding an action for trademark dilution for "(i) advertising or promotion that permits consumers to compare goods or services . . . .").

7. For an example of the presumption in comparative-law scholarship, see KONRAD ZWEIGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 40 (Tony Weir transl., 3d ed. 1998).

is misappropriation or free-riding on trademark goodwill. In this regard, it is important to consider the divergence between U.S. and EU law. Whereas the doctrine of underregulation of comparative advertising on the side of American law may be a blind spot, European over-inclusiveness with respect to the "perfume clause" smacks of overregulation.

This article will address these issues in a comprehensive comparative and economic analysis that is organized as follows: Section II describes the legal landscape in the U.S. and in the EU. Section III investigates the underlying economics of comparative advertising and trademark protection. Section IV combines these legal and economic findings in order to suggest a theoretically consistent and economically efficient regulatory framework. Finally, Section V summarizes our conclusions.

II. THE RAGGED LANDSCAPE OF LEGAL THEORY AND PRACTICE

A closer examination of legal doctrine reveals that cases of imitation claims in comparative advertising, and of product—notably perfume—comparison lists, have been the *bête noire* of trademark and unfair competition lawyers in both the U.S. and Europe. Indeed, American law and European law have established significantly divergent metrics for the analysis of comparative advertising. Moreover, each metric in its own right is far from consistent or settled.

A. *American Law: A World of (Almost) Unrestricted Market Communication*

Essentially, U.S. doctrine does not strictly distinguish between trademark *protection* and unfair competition *prevention*. As opposed to European doctrine,[8] U.S. doctrine features an overarching concept of market-information protection. Accordingly, both trademark protection and unfair competition prevention are primarily intended to protect the consumer from incorrect and misleading information and other information-deteriorating influences by market participants.[9] This approach also predominates with respect to the regulation of comparative advertising. U.S. law confines the analysis, at least in principle, to issues

8. *See infra* Section II.B.

9. For a detailed account, see TIM W. DORNIS, TRADEMARK AND UNFAIR COMPETITION CONFLICTS – HISTORICAL-COMPARATIVE, DOCTRINAL, AND ECONOMIC PERSPECTIVES ch. 4 (Cambridge University Press, forthcoming 2017; available as Open Access at http://dx.doi.org/10.1017.9781316651285).

of consumer confusion and the prevention of misinformation.[10] Hence, as long as no misinformation or confusion emerges, communication about product features and competitors' brands is largely unrestricted. Indeed, American courts have regularly explained that if a seller has the right to copy the public domain features of a competitor's product, she must then have a concurrent right to inform the public of this fact.[11] This liberal perspective has also found its way into the federal trademark statute—the Lanham Act[12]—which actually excludes trademark dilution claims in cases of comparative advertising under a defense of the so-called nominative fair use.[13]

1. *Smith v. Chanel*: Free to Compete, Free to Communicate . . .

The landmark case for product imitations and comparison lists is *Smith v. Chanel*.[14] Although almost half a century old, it still represents good law.[15] The defendant, a seller of cheap fragrances, created the following advertisement for his perfumes:

> Ta'Ron perfumes duplicate 100% perfect the exact scent of the world's finest and most expensive perfumes and colognes at prices that will zoom sales to volumes you have never before experienced.[16]

In addition, the advertisement contained an order blank listing the trademarks of the well-known original perfumes immediately beneath the list of duplicates—in short, a perfume comparison list. The price of the imitation scent was less than 30 percent of the price of the original. The central argument of the appellate court—which effectively denied the plaintiff's claim against the comparison—was that there is a fundamental relationship between the freedom of communication and the freedom of competition:

10. For an overview, see J. THOMAS MCCARTHY, 4 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 25:52 (4th ed., June 2016 update) ("Comparative advertising must be truthful and nonconfusing [sic].").

11. *See, e.g.*, Geisel v. Poynter Products, Inc., 295 F. Supp. 331, 351 (S.D.N.Y. 1968); Calvin Klein Cosmetics Corp. v. Lenox Labs., Inc., 815 F.2d 500, 503 (8th Cir. 1987); Pebble Beach Co. v. Tour 18 I Ltd., 155 F.3d 526, 545 (5th Cir. 1998); MCCARTHY, *supra* note 10, § 25:52.

12. Lanham (TradeMark) Act of 1946, 15 U.S.C. § 1051–1127 (2016)

13. *See id.* § 43(c)(3)(A)(i), 15 U.S.C. § 1125.

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

15. *See, e.g.*, LOUIS ALTMAN & MALLA POLLACK, 6 CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 22:43 (4th ed., updated June 2016); *see also*, Saxony Products, Inc. v. Guerlain, Inc., 513 F.2d 716 (9th Cir. 1975); Calvin Klein Cosmetics Corp. v. Parfums de Coeur, Ltd., 824 F.2d 665 (8th Cir. 1987); *Lenox Labs.*, 815 F.2d at 503.

16. *Smith*, 402 F.2d at 563.

> Since appellees' perfume was unpatented, appellants had a right to copy it, as appellees concede. There was a strong public interest in their doing so, "for imitation is the life blood of competition. It is the unimpeded availability of substantially equivalent units that permits the normal operation of supply and demand to yield the fair price society must pay for a given commodity." But this public benefit might be lost if appellants could not tell potential purchasers that appellants' product was the equivalent of appellees' product. "A competitor's chief weapon is his ability to represent his product as being equivalent and cheaper." The most effective way . . . in which this can be done is to identify the copied article by its trademark or trade name. To prohibit use of a competitor's trademark for the sole purpose of identifying the competitor's product would bar effective communication of claims of equivalence.[17]

In summary, the *Chanel* doctrine gives advertisers great leeway when claims of equivalence or imitation are at stake. The focus is on the public benefits of increased market information rather than the protection of the individual right owner's trademark goodwill.

2. Trademark Goodwill Ignored: The Lanham Act's Blind Spot

Interestingly, the *Chanel* court not only denied any risk of misinformation but also rejected claims for the protection of trademark functions other than source identification. This denial may be due to the fact that the judgment was written at a time of monopoly-phobia. Beginning in the 1930s, U.S. trademark doctrine reflected a general aversion to right extension and a fear of undue monopolization.[18] In the 1960s, the prevailing attitude toward trademark protection was still cautious, as illustrated by the Federal Trade Commission's encouragement of comparative advertising.[19] Despite the fact that the winds may have changed since then, a trademark's sales appeal—in other words, its attractiveness independent of the quality or price of the underlying product—is still deemed an element of consumer "irrationality" and hence is not the primary focus of protection if comparative advertising is the issue. Yet, this hesitation toward—if not complete aversion to—protecting a trademark's goodwill in cases of

17. *Id.* at 567–68.

18. *See* EDWARD HASTINGS CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION: A RE-ORIENTATION OF THE THEORY OF VALUE (1933) (with further editions). From a legal perspective, see also, Ralph S. Brown Jr., *Advertising and the Public Interest: Legal Protection of Trade Symbols*, 57 YALE L.J. 1165, 1168 (1948).

19. *See, e.g.*, Diane M. Reed, *Use Of "Like/Love" Slogans In Advertising: Is The Trademark Owner Protected?*, 26 SAN DIEGO L. REV. 101, 116–17 (1989); *see also, e.g.*, MCCARTHY, *supra* note 10, § 25:52.

comparative advertising strongly contrasts with the general approach to rights protection under the modern anti-dilution doctrine.

At its core, of course, trademark protection in the U.S. is based on the prevention of consumer confusion. Consumers can be confused into believing that the defendant is actually selling the branded product; that the mark owner (i.e., plaintiff) has authorized, endorsed, or sponsored the defendant's product; or that an affiliation, connection, or association between the parties exists.[20] In essence, protection in these cases is based on a concept of securing the accuracy and quality of market information that is transmitted to the consumer.[21] Nonetheless, over the last century, the protection of trademarks has been gradually extended.

Under anti-dilution protection, there is no requirement of consumer misinformation or confusion.[22] Instead, protection is founded on a concept of right owner integrity, notably under the guise of preventing tarnishment or blurring. Tarnishment concerns cases in which the defendant uses the trademark in a way that conflicts with the meanings that consumers associate with the plaintiff's mark.[23] Since tarnishment does not allow the information on the trademarked product's attributes to be correctly inferred by the consumer, it distorts the informative function of trademarks.[24] An oft-enunciated example is the use of "The Tiffany Club" as a name for a strip club: although no one will assume that the jewelry company Tiffany is in the strip club business, the trademark's air of exclusivity and prestige will be damaged—that is, tarnished.[25]

Dilution by blurring is founded on a slightly different rationale. The idea here is that multiple uses of the same mark on different products will, over time, dilute —i.e., "water down" or "whittle away"— the mark's distinctive quality, making it more difficult for consumers to quickly recall the original product.[26] To reiterate the example: If "Tiffany" were used on numerous products (e.g., household goods, cars,

20. Lanham (TradeMark) Act § 43(a)(1)(A), 15 U.S.C. § 1125(a)(1)(A) (2016). *See, e.g.*, MCCARTHY, *supra* note 10, §§ 23:8, 24:6. In addition, there are extensions with respect to the point in time when the confusion must occur. Apart from point-of-sale confusion (at the time of purchase), there can be confusion prior to and subsequent to purchase (initial-interest and post-sale confusion). *See, e.g.*, *id.* §§ 23:6, 23:7.

21. *See* Robert G. Bone, *Hunting Goodwill: A History of the Concept of Goodwill in Trademark Law*, 86 B.U. L. REV. 547, 558 (2006).

22. *See* Moseley v. V Secret Catalogue, Inc., 537 U.S. 418, 429–30 (2003).

23. Daniel Klerman, *Trademark Dilution, Search Costs, and Naked Licensing*, 74 FORDHAM L. REV. 1759, 1762 (2006).

24. Nicholas S. Economides, *"trademarks"*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW sub. 4, at 601 (Peter Newman ed., 1998).

25. Using this example as an explanation, see Ty Inc. v. Perryman, 306 F.3d 509, 511 (7th Cir. 2002) (Posner, J.).

26. *See, e.g.*, Robert N. Klieger, *Trademark Dilution: The Whittling Away of the Rational Basis for Trademark Protection*, 58 U. PITT. L. REV. 789, 823–28 (1997).

food, and even services), consumers might still know that these products have nothing to do with the famous jewelry company. Thus, the trademark's source identification function would not be immediately affected. Nevertheless, the "noise" created by such additional non-owner uses in the marketplace would ultimately make it more difficult for consumers to immediately connect "Tiffany" with "jewelry."

Attempts to explain the anti-blurring policy are diverse. The most predominant among them is based on the concept of search costs.[27] As law and economics scholars have suggested, blurring increases consumer search costs by whittling away the trademark's once-existing distinctiveness, thereby making it costlier for consumers to mentally connect the trademark to the product in the future.[28] Others refer to a deontological morality-based theory of protection against free riding and the misappropriation of others' goodwill.[29] This aim to preclude pure misappropriation has also surfaced in U.S. federal practice.[30] In essence, therefore, legal doctrine still tends to revert to the oft-criticized if-value-then-right conception expressed most vividly by Justice Frankfurter in 1942: "If another poaches upon the commercial magnetism of the symbol he has created, the owner can obtain legal redress."[31]

Interestingly, while the policy debate on tarnishment, blurring, and pure misappropriation has been part of run-of-the-mill trademark infringement cases for decades, it has been virtually nonexistent in cases on comparative advertising. This absence is due to the fact that the

27. *See, e.g.*, *Perryman*, 306 F.3d at 511; WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 207 (2003); Peter S. Menell & Suzanne Scotchmer, *Intellectual Property Law*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 1473, 1552–54 (A. Mitchell Polinsky & Steven Shavell, eds., 2007).

28. This search-cost increase is explained as a so-called *imagination cost*. *See, e.g.*, *Perryman*, 306 F.3d at 511; LANDES & POSNER, *supra* note 27, at 207; *see also, e.g.*, Menell & Scotchmer, *supra* note 27, at 1552–54.

29. *See, e.g.*, David J. Franklyn, *Debunking Dilution Doctrine: Toward a Coherent Theory of the Anti-Free-Rider Principle in American Trademark Law*, 56 HASTINGS L.J. 117, 138–43 (2004).

30. *See, e.g.*, *Perryman*, 306 F.3d at 512 ("Third, and most far-reaching . . . , there is a possible concern with situations in which, though there is neither blurring nor tarnishment, someone is still taking a free ride on the investment of the trademark owner in the trademark.").

31. Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co., 316 U.S. 203, 205 (1942). For a famous and entertaining critique of this approach, see Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935). For the if-value-then-right terminology, see Rochelle Cooper Dreyfuss, *Expressive Genericity: Trademarks as Language in the Pepsi Generation*, 65 NOTRE DAME L. REV. 397, 405 (1990). For a recent summary and overview of case law on the misappropriation doctrine, see, for example, Apostolos Chronopoulos, *Goodwill Appropriation as a Distinct Theory of Trademark Liability: A Study on the Misappropriation Rationale in Trademark and Unfair Competition Law*, 22 TEX. INTELL. PROP. L.J. 253, 291–300 (2014).

federal statute on trademark protection provides an express exception to the dilution doctrine with respect to comparative advertising, which is considered a form of nominative fair use. Section 43(c)(4)(A) of the Lanham Act excludes an action for trademark dilution for "advertising or promotion that permits consumers to compare goods or services." In summary, therefore, although courts are generally willing to prevent trademark tarnishment, the whittling away of distinctiveness, and even mere free riding on a trademark's goodwill or reputation, the standard of scrutiny is significantly diminished whenever a product comparison is at issue.

B. *European Law: The Censorship of Market Information*

The liberal stance of U.S. scholars and courts contrasts almost inexplicably with European doctrine on comparative advertising. Throughout the twentieth century, in many jurisdictions under the continental civil-law tradition, advertising referring to a competitor was considered "unfair" *per se* as an attempt to free ride on or misappropriate another's goodwill and market position.[32] This rigorous regulation—read: prohibition—of comparative advertising was ostensibly abolished for the European Community in 1997 through the enactment of Directive 97/55/EC,[33] which complemented an earlier directive on misleading advertising (84/450/EEC)[34] by including provisions on the general admissibility of comparisons in commercial communication. In 2006, a "final" version of the European rules on comparative advertising was implemented with Directive 2006/114/EC.[35] Notwithstanding this modernization and liberalization, however, a number of gray areas

32. For a general overview, see Rolf Sack, *Vergleichende Werbung nach der UWG-Novelle*, 49 WETTBEWERB IN RECHT UND PRAXIS [WRP] 327, 327–28 (2001) (Ger.); furthermore, (with respect to the member states' national laws), e.g., for Spain, Carlos Lema Devesa, *Die „Duftvergleichslisten" im Lichte des* Gemeinschaftsmarkenrechts, 58 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT INTERNATIONALER TEIL [GRUR-INT.] 118, 119 (2009) (Ger.); for Austria, Helmut Gamerith, *Auswirkungen der Richtlinie 97/55/EG auf das österreichische Wettbewerbsrecht*, ÖSTERREICHISCHE BLÄTTER FÜR GEWERBLICHEN RECHTSSCHUTZ UND URHEBERRECHT [ÖBl] 115,117–19 (1998) (Austria); for France, Charlotte J. Romano, *Comparative Advertising in the United States and in France*, 25 NW. J. INT'L L. & BUS. 371, 379–86, 400–12 (2005).

33. Directive 1997/55, of the European Parliament and of the Council of 6 October 1997 Amending Directive 84/450/EEC Concerning Misleading Advertising so as to Include Comparative Advertising, 1997 O.J. (L 290) 18 (EC).

34. Directive 1984/450, of the Council of 10 September 1984 Relating to the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Misleading Advertising, 1984 O.J. (L 250) 17 (EEC).

35. *See* Directive 2006/114, of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 21 (EC).

persist, especially with regard to imitation claims and product comparison lists. Indeed, as a closer look at the directive and its implementation in member states reveals, the regulation of such advertising comparisons continues to reflect an obsolete policy of market-information censorship.

1. Private Rights vs. Public Information

The most fundamental problem with respect to the regulation of comparative advertising can be found in the dichotomy of European civil-law doctrine. While trademark protection used to be conceived of as a sub-category of unfair competition law in the past, modern trademark protection and unfair competition prevention are perceived as separate fields.[36] Whereas one protects individuals' exclusive rights, the other safeguards market participants' commercial conduct and the functioning of the marketplace. Not surprisingly, the fields' differentiation is a recurring issue in many cases.[37]

Indeed, scenarios of comparative advertising were formerly a key arena in the battle over which rules should be given priority—those on trademark rights protection or those on unfair competition prevention. Today, it is agreed that reference to a competitor's trademark in comparative advertising may constitute "trademark use" and hence may also infringe on the trademark to which it refers.[38] However, European lawmakers have also made it clear that rules on unfair competition prevention concerning comparative advertising take priority over the rules providing for individual trademark rights protection. As recital 15 of Directive 2006/114/EC explains:

> Use of another's trade mark, trade name or other distinguishing marks [in comparative advertising] does not breach [a trademark owner's] exclusive right in cases where it complies with the conditions laid down by this directive, the intended target being

36. For the history and the present, see, e.g., DORNIS, *supra* note 9, ch. 1.

37. For the status of current legal doctrine and the relationship between trademark protection and unfair competition prevention in Germany and Europe, see Franz Hacker, *§ 2 MarkenG*, *in* MARKENGESETZ-KOMMENTAR, ¶¶ 5, 6 (Paul Ströbele & Franz Hacker eds., 11th ed., 2015); for a historical-comparative overview of European and U.S. doctrine, see DORNIS, *supra* note 9.

38. *See, e.g.*, Case C-533/06, O2 v. Hutchinson, 2008 E.C.R. I-04231 ¶¶ 33, 36, 37; Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185 ¶¶ 53, 65; *see, e.g.*, Burkhart Menke, *§ 6 UWG*, *in* MÜNCHENER KOMMENTAR ZUM LAUTERKEITSRECHT, ¶¶ 49–52 (Peter W. Heermann & Jochen Schlingloff eds., 2d ed. 2014).

> solely to distinguish between them and thus to highlight differences objectively.[39]

The Court of Justice further clarified these relations in its 2008 *O_2 Holdings Ltd.*[40] judgment declaring that "the Community legislature considered that the need to promote comparative advertising required that the right conferred by the mark be limited to a certain extent."[41] On this basis, as the judges concluded, "in order to reconcile the protection of registered marks and the use of comparative advertising," the European law on trademark protection and on comparative and misleading advertising

> [M]ust be interpreted to the effect that the proprietor of a registered trade mark is not entitled to prevent the use, by a third party, of a sign identical with, or similar to, his mark, in a comparative advertisement which satisfies all the conditions . . . under which comparative advertising is permitted.[42]

Although this rule of "unfair competition priority" seems to have settled the debate, we will see below that the actual correlations between private rights protection (trademark law) and market-conduct regulation (unfair competition law) are far from explicit. Indeed, the conflict can still be explained as a battle between the private right owner's interest in "less" and the public's interest in "more" marketplace communication and information.

2. Brussels' French Signature: The "Perfume Clause" as a *Per Se* Prohibition

Viewed in light of communication efficiency, it is not surprising that imitation claims are a popular marketing tool for product copies with few relevant or important features. Perfumes and their smell-alikes are prime examples. Accordingly, phrases like "Smells like Chanel No. 5" or "If you like J'Adore, you will love Jamais" are common in U.S. advertising. As we have seen, if they are not found to be confusing or deceptive, such claims are considered neither trademark infringing nor

39. Directive 2006/114, of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 22 (EC).

40. Case C-533/06, O2 v. Hutchinson, 2008 E.C.R. I-04231

41. *Id.* ¶ 39.

42. *Id.* ¶¶ 45, 51; *see also L'Oréal*, 2009 E.C.R. I-05185 ¶ 54; for Germany, see, e.g., Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 02, 2015, 117 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 1136 (1137 ¶ 17), 2015 (Staubsaugerbeutel im Internet) (Ger.).

unfairly competitive.[43] This is not the case in Europe. As article 4(g) of Directive 2006/114/EC provides, comparative advertising shall, among other conditions, be permitted only if "it does not present goods or services as imitations or replicas of goods or services bearing a protected trade mark or trade name."[44]

This *per se* prohibition reflects a long tradition in many member states' legislatures.[45] Therefore, it is not surprising that the provision was inserted into the directive after forceful interference in the European lawmaking process by the French luxury perfume industry—hence, the name "perfume clause."[46]

The clause's subsequent integration into member states' national laws has elicited a plethora of unclarified issues. One example can be found in German practice, where many cases center on the question of how to distinguish non-permissible "imitation claims" from the legitimate provision of mere information on product equivalence. In this regard, the Federal Court of Justice (*Bundesgerichtshof*) has settled on a rather obscure formula: Comparative advertising must avoid the express use of the terms "imitation," "replication," and "replica" in order to not be characterized as non-permissible.[47] It is, however, permissible to claim mere product "equivalence."[48] Not surprisingly, practical problems remain. Especially in cases where information in comparative advertising only *implicitly* transfers a message of "imitation," the rule of *ad hoc* decision-making is anything but clear. In this respect, it has been particularly problematic to assess the legality of advertising that avoids using the word "imitation" but uses alternative means to claim an exact

43. *See supra* Part II.A.

44. Directive 2006/114, of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 23, art. 4 (EC).

45. For Germany, see, e.g., Oberlandesgericht München [OLG] [Higher Regional Court of Munich] Feb. 19, 1987, 89 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 299 (300), 1987 (OPTIMUM) (Ger.); for Spain, Devesa, *supra* note 32, at 119 (with reference to case law); for France, Romano, *supra* note 32, at 379, 400; for Austria, Gamerith, *supra* note 32, at 117–19.

46. *See, e.g.*, Romano, *supra* note 32, at 400.

47. *See, e.g.*, BGH Dec. 4, 2008, 111 GRUR 871 (873 ¶ 31), 2009 (Ohrclips) (Ger.); BGH Oct. 1, 2009, 112 GRUR 323 (324 ¶ 29), 2010 (Oracle) (Ger.); 117 GRUR 1136 (1140) (Staubsaugerbeutel im Internet) (Ger.). For scholarly commentary, see, e.g., Jochen Glöckner, *§ 6 UWG*, *in* GROßKOMMENTAR ZUM GESETZ GEGEN DEN UNLAUTEREN WETTBEWERB MIT NEBENGESETZEN ¶ 566 (Otto Teplitzky et. al. eds., 2d ed. 2014).

48. *See, e.g.*, BGH Dec. 6, 2007, 110 GRUR 628 (631), 2008 (Imitationswerbung) (Ger.); 112 GRUR 343 (345) (Oracle) (Ger.); BGH May 5, 2011, 113 GRUR 1153 (1155), 2011 (Creation Lamis) (Ger.).

product replication, notably the use of graphic elements with a "look and feel" similar to that of the original product and trademark personae.[49]

As a result, in many cases, the practical outcome is unclear, which indicates that the issue requires further analysis—particularly one that explores the perfume clause's economic underpinnings. In this regard, we must also focus on the legal doctrines currently "in the shadow" of the perfume clause. Should the provision be found to be over-inclusive, other doctrines, such as the prevention of confusion and misinformation and the prevention of misappropriation, will ultimately be required to provide the metric for legal scrutiny.

3. Under the Surface: Preventing Misinformation and Misappropriation

In essence, under existing law, the perfume clause's sweeping protection of owners of original brands engulfs virtually all other issues that may arise with respect to the legality of comparative advertising. Therefore, on its face, the clause tends to suppress a wider, more intensive debate on the adequate structure of regulation for imitation claims. In order to provide the groundwork for an economic analysis, it is necessary to sketch the basic doctrines found under the surface of the perfume clause.

Besides prohibiting imitation claims, Directive 2006/114/EC establishes a number of more general requirements that comparative advertising must fulfill in order to not be considered unfair. Fundamentally, such advertising must not mislead, confuse, or take unfair advantage of a competitor's trademark.[50]

With respect to the protection of consumers' and businesses' decision-making, comparative advertising is subjected to a standard of information correctness and objectivity. As stated in article 4(a), (b), (c), and (h), the comparison must not be misleading or deceptive.[51] According to article 4(a), the comparison must not contain "false information and . . . therefore [be] untruthful or in any way, including overall presentation, deceive or [be] likely to deceive the average

49. *See, e.g.*, Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185 ¶ 75; 110 GRUR 628 (631 ¶ 26) (Imitationswerbung) (Ger.); BGH Jul. 22, 2010, 113 GRUR 152 (156 ¶ 49), 2011(Kinderhochstühle im Internet) (Ger.). For scholarly commentary, see, e.g., Menke, *supra* note 38, at ¶¶ 310–13.

50. *See* Directive 2006/114, of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 21, 23, art. 4 (EC).

51. *Id.*

consumer."[52] Furthermore, the comparison must not cause deception by an omission of material information.[53] With respect to B2B transactions, article 4(h) prohibits creating "confusion among traders, between the advertiser and a competitor or between the advertiser's trade marks, trade names, other distinguishing marks, goods or services and those of a competitor." In the same vein, comparative advertising must "compare goods or services meeting the same needs or intended for the same purpose" (art. 4(b)) and "objectively compare one or more material, relevant, verifiable and representative features of . . . goods and services [including prices]" (art. 4(c)).[54]

In addition, a second category of conditions exists to establish the legitimacy of a comparison. This category was not designed to focus on consumers' or other market participants' decision-making process or its protection against undue manipulation. Rather, it concerns the protection of the trademark owner's goodwill against injury and misappropriation. This category is covered in article 4(d) and (f) of Directive 2006/114/EC.

Article 4(d) requires that comparative advertising "not discredit or denigrate the trade marks, trade names, other distinguishing marks, goods, services, activities or circumstances of a competitor." This prohibition encompasses instances of trademark tarnishment, in which a mark's repute is damaged by a competitor, notably by the competitor's use of unfavorable associations.[55] In addition, article 4(f) states that comparative advertising must "not take unfair advantage of the reputation of a trade mark, trade name or other distinguishing marks of a competitor or of the designation of origin of competing products." In this regard, two further categories of infringement must be differentiated. First, the use of a trademark by a non-owner can be detrimental to the distinctive character of the mark, a condition referred to as "dilution," "whittling away," or "blurring." Such dilution follows from a decrease in the mark's ability to identify the goods or services for which it is registered and used, since its use by others leads to the dispersion of the mark's identity and hold upon the public's mind.[56] Such cases of

52. *Id. See also* Directive 2005/29, of the European Parliament and of the Council of 11 May 2005 Concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market and Amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive'), 2006 O.J. (L 149) 22, 28, art. 6(1) (EC).

53. *See id.* at 28, art. 7(1).

54. For products with designations of origin, art. 4(e) provides for the comparison to relate only to products with the same origin. This provision also reflects a policy of misinformation prevention by means of avoiding a comparison of "apples and oranges."

55. *See, e.g.*, Case C-252/07, Intel v. CPM United Kingdom Ltd, 2008 E.C.R. I-08823 ¶ 27.

56. For the European doctrine, see, e.g., *id.* at ¶ 29.

potential trademark injury, however, are covered neither by article 4(d) nor by article 4(f) of the directive. Accordingly, mere dilution will not be considered sufficient to establish a case of improper comparative advertising.[57] Thus, only the second category of free-riding or misappropriation must be tested under article 4(f). With respect to this category, the Court of Justice offered an insightful explanation in its ruling in *L'Oréal/Bellure*[58]:

> As regards the concept of "taking unfair advantage of the distinctive character or the repute of the trade mark," also referred to as "parasitism" or "free-riding," that concept relates not to the detriment caused to the mark but to the advantage taken by the third party as a result of the use of the identical or similar sign. It covers, in particular, cases where, by reason of a transfer of the image of the mark or of the characteristics which it projects to the goods identified by the identical or similar sign, there is clear exploitation on the coat-tails of the mark with a reputation . . . . In that regard, where a third party attempts, through the use of a sign similar to a mark with a reputation, to ride on the coat-tails of that mark in order to benefit from its power of attraction, its reputation and its prestige, and to exploit, without paying any financial compensation and without being required to make efforts of his own in that regard, the marketing effort expended by the proprietor of that mark in order to create and maintain the image of that mark, the advantage resulting from such use must be considered to be an advantage that has been unfairly taken of the distinctive character or the repute of that mark.[59]

This "judge-made" morality-based concept of unfairness aimed at Lockean-style protection of the trademark owner's investment has found support in scholarly theory.[60] With respect to comparative advertising and perfume comparison lists, commentary in Europe explains that the purchase of an imitation is often solely motivated by the aim to participate in the exclusivity and luxury character of the original brand and product. Since this motivation is not considered legitimate—not even on the consumer's side—a competitor's attempt to profit is perceived as unfair competition.[61]

57. *See, e.g.*, BGH Sep. 28, 2011, 113 GRUR 1158 (1159 ¶ 21), 2011 (Teddybär) (Ger.); 117 GRUR 1136 (1139 ¶ 38) (Staubsaugerbeutel im Internet) (Ger.).

58. Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185.

59. *See id.* ¶¶ 41, 49.

60. *See, e.g.*, Ansgar Ohly & Michael Spence, *Vergleichende Werbung: Die Auslegung der Richtlinie 97/55/EG in Deutschland und Großbritannien*, 48 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT INTERNATIONALER TEIL [GRUR-INT.] 681, 695 (1999) (Ger.); Menke, *supra* note 38, at ¶ 270. For a critique see, e.g., Dornis & Wein, *supra note 5*.

61. *See, e.g.*, Ohly & Spence, *supra* note 60; Menke, *supra* note 38, at ¶ 270.

However, the practical implementation of this doctrine is ambiguous. It shares the inherent defects of any *ad hoc* decision-making: a lack of structure and practical replicability of the results. Recital 14 of Directive 2006/114/EC suggests a multi-factor test. Specifically, it states:

> It may, however, be indispensable, in order to make comparative advertising effective, to identify the goods or services of a competitor, making reference to a trade mark or trade name of which the latter is the proprietor.[62]

Essentially, the notion of "indispensability" is interpreted as establishing a principle of proportionality, making it necessary to tolerate a certain degree of injury to trademarks or trade names insofar as an effective comparison is needed.[63]

Among the aspects to be considered in this *ad hoc* balancing are

- the strength of the mark's reputation and the degree of its distinctive character;
- the degree of similarity between the marks at issue;
- the nature and degree of proximity of the goods or services concerned; and
- the likelihood of dilution or tarnishment of the mark.[64]

In practice, the principle of indispensability or proportionality is interpreted as a rule of minimum impact. The advertiser is allowed to make use of a competitor's trademark only insofar as such use is deemed inevitable. Using a competitor's item or article numbers (known as OEM product numbers) or non-trademark designations is usually seen as unproblematic.[65] However, it is disputed whether and to what extent the

62. Directive 2006/114, of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising (Codified Version), 2006 O.J. (L 376) 21, 22, Preamble (EC).

63. *See, e.g.*, Case C-112/99, Toshiba v. Katun, 2001 E.C.R. I-07945 ¶ 54; Case C-59/05, Siemens v. VIPA, 2006 E.C.R. I-02147 ¶ 15; 113 GRUR 1158 (1160) (Teddybär) (Ger.); BGH Apr. 14, 2011, 113 GRUR 1135 (1138), 2011 (Grosse Inspektion für Alle) (Ger.); Ohly & Spence, *supra* note 60, at 689; Helmut Köhler, *§ 6 UWG*, *in* KOMMENTAR: GESETZ GEGEN DEN UNLAUTEREN WETTBEWERB: UWG MIT PANGV, UKLAG, DL-INFOV ¶¶ 156–64 (Helmut Köhler & Joachim Bornkamm eds., 34th ed. 2016); Stefan Koos, *§ 6 UWG*, *in* KOMMENTAR ZUM GESETZ GEGEN DEN UNLAUTEREN WETTBEWERB ¶¶ 37, 225 (Karl-Heinz Fezer et. al. eds., 3d ed. 2016).

64. *See* Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185 ¶¶ 44–45; 117 GRUR 1136 (1138) (Staubsaugerbeutel im Internet) (Ger.); *see also* Köhler, *supra* note 63, at ¶ 156; Glöckner, *supra* note 47, at ¶¶ 486–89.

65. *See, e.g.*, Case C-112/99, Toshiba v. Katun, 2001 E.C.R. I-07945 ¶ 49; Case C-59/05, Siemens v. VIPA, 2006 E.C.R. I-02147 ¶ 26; 113 GRUR 1158 (1160 ¶ 24) (Teddybär) (Ger.). For scholarly commentary, see, e.g., Menke, *supra* note 38, at ¶¶ 260, 264–66; Ansgar Ohly, *§ 6 UWG, in* KOMMENTAR: GESETZ GEGEN DEN UNLAUTEREN

use of a *graphic* trademark is admissible if comparative advertising would also have been possible through reference to a competitor's *word* mark.[66] In any event, the extensive use of graphic symbols is only rarely deemed permissible. Another case that is regularly considered to be unfair comparative advertising is the use of a competitor's trademark as an "eye catcher," notably with respect to sales on websites such as eBay.[67] Ultimately, many instances of comparative advertising are deemed improper due to an "excess" of the proportionality threshold.

Finally, another aspect of "product differentiation" enters the debate. As is sometimes argued,[68] claims of imitation regarding products that are purchased primarily to benefit from their "image" and "prestige" should be treated differently from claims regarding products for which this is not the case, such as when generic medications are compared to the original branded product. With respect to medications, the argument goes, the standard of legal scrutiny should be less rigid, allowing for more extensive and intensive references to the original product and trademark. The implication is that increased competition will lower costs in the public health sector.[69] Although this distinction seems plausible at first sight, it is not supported by the directive's language, which neglects to categorize comparative advertising according to the

WETTBEWERB: UWG MIT PREISANGABENVERORDNUNG ¶ 63b (Ansgar Ohly & Olaf Sosnitza eds., 7th ed. 2016); Glöckner, *supra* note 47, at ¶ 501.

66. *Compare* Oberlandesgericht Köln [OLG] [Higher Regional Court of Cologne] Aug. 31, 2007, 8 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT RECHTSPRECHUNGS-REPORT [GRUR-RR] 315 (316), 2008 (Produktalternative) (Ger.); Frauke Henning-Bodewig, *Vergleichende Werbung - Liberalisierung des deutschen Rechts? Zugleich eine Besprechung der Urteile des BGH vom 5. Februar, 23. April und 15. Oktober 1998*, 48 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT INTERNATIONALER TEIL [GRUR-INT.] 385, 393 (1999); Köhler, *supra* note 63, at ¶ 157; *with* CHRISTINE FREUND, VERGLEICHENDE WERBUNG NACH DER RICHTLINIE 97/55/EG UND DER UWG-NOVELLE 152 (2001); Menke, *supra* note 38, at ¶ 271; Glöckner, *supra* note 47, at ¶ 496.

67. *See, e.g.*, Kammergericht Berlin [KG] [Court of Appeal in Berlin] Mar. 4, 2005, 8 MULTIMEDIA UND RECHT [MMR] 315, 2005 (Wettbewerbswidriger Auftritt bei eBay) (Ger.); Koos, *supra* note 63, at ¶ 231; Ohly, *supra* note 65. *But see, e.g.*, Menke, *supra* note 38, at ¶ 272.

68. *See, e.g.*, Michael Lehmann, *Die wettbewerbswidrige Ausnutzung und Beeinträchtigung des guten Rufs bekannter Marken, Namen und Herkunftsangaben — Die Rechtslage in der Bundesrepublik Deutschland*, 35 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT INTERNATIONALER TEIL [GRUR-INT.] 6, 12, 16, 24 n.174 (1986); BURKHART MENKE, RECHT UND ÖKONOMIE DER KRITISIERENDEN VERGLEICHENDEN WERBUNG 198 (1994); Ohly & Spence, *supra* note 60, at 694–695; FREUND, *supra* note 66, at 160; Koos, *supra* note 63, at ¶¶ 291–97; Menke, *supra* note 38, at ¶¶ 316–17; Glöckner, *supra* note 47, at ¶ 585.

69. *See, e.g.*, Lehmann, *supra* note 68; MENKE, *supra* note 68, at 198; Ohly & Spence, *supra* note 60, at 694–95; FREUND, *supra* note 66, at 160; Koos, *supra* note 63, at ¶¶ 291–297; Menke, *supra* note 38, at ¶¶ 316–17; Glöckner, *supra* note 47, at ¶ 585.

type of product at issue. In addition, as we will explore in more detail below, such differentiation carries the risk of economic distortion.[70]

Ultimately, the product-differentiation argument highlights, instead, the underlying conundrum of producers of luxury perfume: Many jurisdictions do not provide special protection for scents. As a result, the extension of unfair competition prevention by means of a quasi censorship of market communication serves as a substitute for the lack of actual intellectual property protection.[71]

C. *The Lawyers' Maze: An Unexpected Transatlantic Dichotomy*

The differences between American and European law are striking. The only area in which both systems seem to overlap is with regard to consumer confusion and misinformation prevention. With respect to dilution prevention, European lawyers exaggerate ideas of misappropriation prevention, while their American counterparts take the concern for trademark goodwill protection too casually. In a sense, European and American trademark lawyers are caught between Scylla and Charybdis. In Europe, the law has settled on a dubious foundation of interest-group opportunism (to the benefit of luxury perfume producers) at the expense of freedom of market information and consumer rationality. In the U.S., right owners may fear an almost Hobbesian state of imitators' liberties. Unless the imitator's intention is misinformation, her utilization of a competitor's trademark in comparative advertising is virtually unrestricted.

From an economic perspective, the European *per se* prohibition of imitation claims is questionable. There may indeed be a risk of misrepresentation, but an undifferentiated blanket prohibition is inefficient. It is also true that the misappropriation of trademark goodwill through comparative advertising presents a separate risk in addition to consumer misinformation. Nevertheless, this risk does not justify a complete ban on imitation claims. By contrast, an economically reasonable approach requires paying close attention to both the detrimental and beneficial effects of product comparisons with reference to competitors' trademarks. It is in this respect that U.S. doctrine may have overshot the mark by limiting the scope of the Lanham Act's prohibition on dilution in cases of comparative advertising. Although a comparison may not necessarily entail tarnishment, blurring, or pure misappropriation, at least a cursory look should be given to the potential negative effects on trademark goodwill in order to ensure that there is no

70. *See infra* Part IV.C.3.
71. For the lack of IP protection for perfume, see, e.g., Ruess, *supra* note 3, at 499; Glöckner, *supra* note 47, at ¶ 583.

detriment other than mere misinformation. Considering that American lawyers are generally willing to protect trademarks against such appropriation, it is vexing to see protection levels lowered so significantly whenever a case smacks of comparative advertising.

III. THE WAY OUT: AN ECONOMIC RE-ANALYSIS OF COMPARATIVE ADVERTISING AND TRADEMARK PROTECTION

Although there are robust economic analyses of intellectual property law, there is no comprehensive economic explanation of trademark protection.[72] The most basic and widely acknowledged concept of confusion prevention, developed by William M. Landes and Richard A. Posner in 1987, is built on the informative function of trademarks. Their search-cost model may also help explain cases of trademark dilution by blurring. Nevertheless, with respect to further extensions of rights protection, notably cases of "pure misappropriation," it is not too meaningful.[73] Seen in this light, it is not surprising that other leading law-and-economics scholars have expressed their resignation with respect to a methodologically appropriate handling of goodwill protection beyond confusion prevention.[74] This insecurity also severely undermines a solid conceptualization of the confines for the legality of comparative advertising. Yet this is no reason for despair. On the contrary, an economically consistent and legally workable standard of regulation can be devised on the basis of two elements: the economic theory of advertising, with a special focus on comparative advertising and its functions, and trademark protection models, from a perspective of both confusion prevention under the search-cost model and goodwill protection beyond the search-cost concept.

72. For an overview of the "burgeoning literature on the law and economics of intellectual property" in general, see, e.g., Menell & Scotchmer, *supra* note 27, at 1474–55.

73. *See* William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 307–08 (1987). More than 20 years later, their analysis remains substantially unchanged. *See* LANDES & POSNER, *supra* note 27, at 206–09. With respect to the absence of goodwill misappropriation analysis, see also the non-discussion of the issue in, e.g., THOMAS J. MICELIS, THE ECONOMIC APPROACH TO LAW 184–85 (2d ed. 2008); STEPHEN J. SPURR, ECONOMIC FOUNDATIONS OF LAW 93–95 (2d ed. 2010).

74. *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 133 (6th ed. 2014) ("Besides quality, trademarks also signal prestige . . . . Unfortunately, standard economic tools were not designed for prestige . . ."); for an earlier critique in Europe, see 1 FRAUKE HENNING-BODEWIG & ANETTE KUR, MARKE UND VERBRAUCHER: FUNKTIONEN DER MARKE IN DER MARKTWIRTSCHAFT 268 (1988).

A. *The Functions of Advertising*

A systematic approach to the regulation of market communication in the context of comparative advertising can be formulated by reference to several aspects of economic theory. Until now, these aspects have been discussed separately without regard to the way they overlap and interact with one another. It is the combination of insights that the theory of advertising functions and trademark protection offers that provides the theoretical foundation for a cost-benefit-oriented framework, particularly with respect to imitation claims and comparison lists.

1. General Theory

The fundamental theory behind nearly all models of advertising functions is George J. Stigler's concept of information economics.[75] More than half a century ago, Stigler laid the foundation for an economic theory of market information. As he explained, the basic function of advertising is to transmit information within the marketplace; it informs consumers about the properties of goods, particularly their prices.[76] As a consequence of augmented and better marketplace information, the market's allocative efficiency is enhanced, resulting in the growth of the community's accumulated welfare.[77]

Ever since, additional benefits of advertising have been pointed out. Another most famous theory on advertising is Philip Nelson's explanation of the indirect effect of generic advertising.[78] In his model, advertising transmits information but does not *directly* inform consumers about a product's properties or prices. Instead, it allows consumers to conclude something else about the product. This is not the same kind of information transmission discussed in Stigler's model; rather, it is an indirect form of transmission: through advertising, the producer illustrates that, compared to her competitors, she is able and willing to invest in market information of a certain kind. The background assumption is that only an actor selling a high-quality product can afford such expenses. If that were not the case (i.e., if the advertiser did not produce high-quality products), she would eventually vanish from the market.[79] In this regard, Richard Schmalensee has illustrated that an

75. George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961). For an earlier and very instructive article, see Brown, *supra* note 18.

76. Stigler, *supra* note 75, at 216–218.

77. *Id.* at 220.

78. Phillip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311 (1970); Phillip Nelson, *Advertising as Information*, 82 J. POL. ECON. 729 (1974).

79. *See, e.g.*, Jack Hirshleifer, *Where Are We in the Theory of Information?*, 63 AM. ECON. REV. 31, 37–38 (1973); Benjamin Klein & Keith B. Leffler, *The Role of*

equilibrium is possible when high-quality producers advertise widely and low-quality producers refrain from extensive advertising. Ultimately, the market will come to an equilibrium in which both kinds of producers coexist.[80]

Finally, George Stigler and Gary Becker have conceived of another dimension of advertising activity. As they explain, advertising can be more than mere "information;" it can also "affect" consumers beyond its objective content. In other words, consumers may have stable preferences, but advertising can influence these preferences in any direction.[81] In this regard, advertising's capacity to influence—more drastically put, to *manipulate*—consumer decision-making comes into focus.[82] Although modern economic theory is less skeptical, it still involves a certain level of opposition to marketing practices founded on product differentiation through branding and persuasive marketing.[83] Not surprisingly, Edward Hastings Chamberlin's 1930s model of monopolistic competition is still being debated.[84] As Chamberlin explained, marketplace conditions with a wide array of branded products engender perfect competition, except that each seller offers a differentiated version of the commodity. In principle, these products compete among themselves for consumers' favor. Yet competition is not based merely on products' qualities and their market prices. It is based on the products' differentiation—specifically through branding. Ultimately, the function of trademarks in monopolistic-competition markets is to establish and maintain consumer preferences and brand

Market Forces in Assuring Contractual Performance, 89 J. POL. ECON. 615, 630–31 (1981); Paul Milgrom & John Roberts, *Price and Advertising Signals of Product Quality*, 94 J. POL. ECON. 796 (1986).

80. Richard Schmalensee, *A Model of Advertising and Product Quality*, 86 J. POL. ECON. 485 (1978).

81. George J. Stigler & Gary S. Becker, *De Gustibus Non Est Disputandum*, 67 AM. ECON. REV. 76, 83–87 (1977).

82. Gary S. Becker & Kevin M. Murphy, *A Simple Theory of Advertising as a Good or Bad*, 108 Q. J. ECON. 941, 945–52 (1993).

83. *See, e.g.*, Avery M. Abernethy & George R. Franke, *The Information Content of Advertising: A Meta-Analysis*, 25 J. Advert. 1, 7–14 (1996); Antonella Nocco, Gianmarco I.P. Ottaviano & Matteo Salto, Monopolistic Competition and Optimum Product Selection, 104 AM. ECON. REV. 304, 304–09 (2014).

84. For the model, see EDWARD HASTINGS CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION: A RE-ORIENTATION OF THE THEORY OF VALUE 56–70 (7th ed. 1956). For an early discussion in legal terms see, e.g., Brown, *supra* note 18, at 1168–75. For the modern debate see, e.g., Daniel M. McClure, *Trademarks and Unfair Competition: A Critical History of Legal Thought*, 69 Trademark Rep. 305 (1979); Nicholas S. Economides, *The Economics of Trademarks*, 78 Trademark Rep. 523 (1988); Glynn S. Lunney, Jr., *Trademark Monopolies*, 48 EMORY L.J. 367 (1999); Herbert Hovenkamp, *United States Competition Policy in Crisis: 1890-1955*, 94 MINN. L. REV. 311 (2009); Deven R. Desai, *The Chicago School Trap in Trademark: The Co-Evolution of Corporate, Antitrust, and Trademark Law*, 37 CARDOZO L. REV. 551 (2015).

loyalty. One result of branding and persuasive advertising, as is still argued today, is that consumers may be willing to pay a premium beyond the product price. Moreover, entry barriers might ensue, thereby decreasing competition.[85]

In summary, analyses of the functions of advertising in general have not seen any groundbreaking changes in recent decades. Any kind of truthful advertising activity concerning product properties and prices will increase the amount of information available to consumers in the marketplace. While most scholars and practitioners acknowledge the net benefit of such an increase in information, critical voices still point out the potential downsides of advertising, especially the risk of creating market entry barriers by means of extended trademark protection.

2. The Special Case: Comparative Advertising

Compared to the number of scholarly analyses of advertising in general, more elaborate models on the functions and benefits of comparative advertising are rare. Indeed, the discussion of comparative advertising is a rather young debate. Nevertheless, two basic scholarly endeavors in the field are relevant to our inquiry.

As Simon Anderson and Régis Renault suggest,[86] consumers viewing advertising information are primarily observing a product's qualities and price. Quite often, however, they do not know if the product will actually comply with their expectations regarding quality and attributes. This is explained as a lack of knowledge with respect to so-called match value or valuation.[87] As the authors explain, comparative advertising is an instrument particularly well suited to overcoming this information deficit. By advertising comparatively, producers can provide consumers with information about the conformity of consumer expectations and product qualities. An advertiser will thus have a strong incentive to disclose her own product's match valuation, or both her own product's match valuation and that of her competitor if she

85. *See* CHAMBERLIN, *supra* note 84, at 56–70; Brown, *supra* note 18, at 1168–75; furthermore see also, McClure, *supra* note 84, at 329–30; Economides, *supra* note 84, at 533–34; Lunney, *supra* note 84, at 422–31; Hovenkamp, *supra* note 84, at 336–39; Desai, *supra* note 84, at 603–04. In addition, even though trademark protection theory "Chicago style" has come to dominate in the WIPO, their 2013 World Intellectual Property Report is not free of doubts either. *See Brands — Reputation and Image in the Global Marketplace,* WORLD INTELL. PROP. REP. (World Intell. Prop. Org., Geneva, Switz.), 2013, at 17 ("[I]n certain situations, strong brands can create high barriers to market entry, as new competitors may not be able to bear the high advertising costs of inducing consumers to switch to their products.").

86. Simon P. Anderson. & Régis Renault, *Comparative Advertising: Disclosing Horizontal Match Information*, 40 RAND J. ECON. 558, 560–77 (2009).

87. Anderson & Renault, *supra* note 86, at 564.

expects the consumers to value her product more highly under a comparative description.

Furthermore, Francesca Barigozzi, Paolo G. Garella, and Martin Peitz have illustrated an additional aspect of comparative advertising that is often ignored in legal doctrine.[88] As they explain, comparative advertising differs from generic advertising insofar as it must be submitted to a particularly strict examination. Whereas generic advertising can be assessed more liberally with respect to exaggerations and hyperbole, comparative advertising cannot. Here, the detrimental effects of misinformation in the marketplace can be avoided only through rigorous factual scrutiny. The reason is thus: if the comparison cannot be verified or refuted by competitors and third parties (notably courts), advertisers have a strong incentive to misinform. On the other hand, if comparative advertising is allowed only under preconditions of strict factual correctness and if violations are enforced effectively, misinformation is prohibitively expensive and will not be pursued.[89]

On this basis, a simple explanation of the relevant functions of comparative advertising can be attempted. Figures 1 and 2 help illustrate the positive effects of product comparisons:

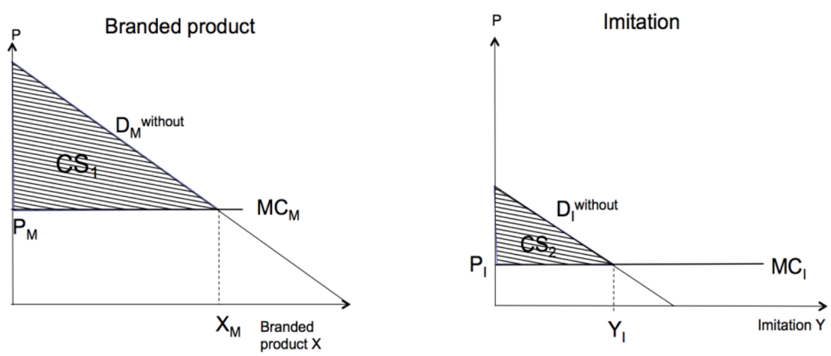

Figure 1: Markets without comparative advertising

The graph on the left side of Figure 1 describes the situation of trademark holder M, who produces branded product X. The graph on the right shows product Y, which is produced by imitator I. For simplicity's sake, both actors are assumed to work under constant marginal costs. However, the trademark holder has higher marginal costs compared to

88. Francesca Barigozzi, Paolo G. Garella & Martin Peitz, *With a Little Help from My Enemy: Comparative Advertising as a Signal of Quality*, 18 J. ECON. & MGMT. STRATEGY 1071, 1076–88 (2009).
89. *Id.* at 1090–91.

the imitator ($MC_M > MC_I$). These costs result from the expense of establishing and maintaining both the trademark and its goodwill.

In the absence of comparative advertising, consumers are faced with demand curves $D_M^{without}$ and $D_I^{without}$. Because competition exists in both markets, consumers of the imitation have to pay price P_I and buy the quantity Y_I. However, customers of the branded product must pay the higher P_M price, accompanied by the quantity X_M.

Both groups of consumers would be willing to pay a price exceeding the market price (P_M/P_I). This is reflected in the areas below the demand functions $D_M^{without}$ and $D_I^{without}$ up to the consumed quantities X_M and Y_I. Both areas represent the monetary equivalents of the total utility extracted from consuming the branded product and the imitation. Since consumers actually pay only the market price (P_M/P_I), however, they ultimately receive net benefits (consumer surplus) represented by the striped triangles CS_1 (right) and CS_2 (left).

Now let us assume that imitator I is advertising comparatively. Figure 2 illustrates the marketplace effects.

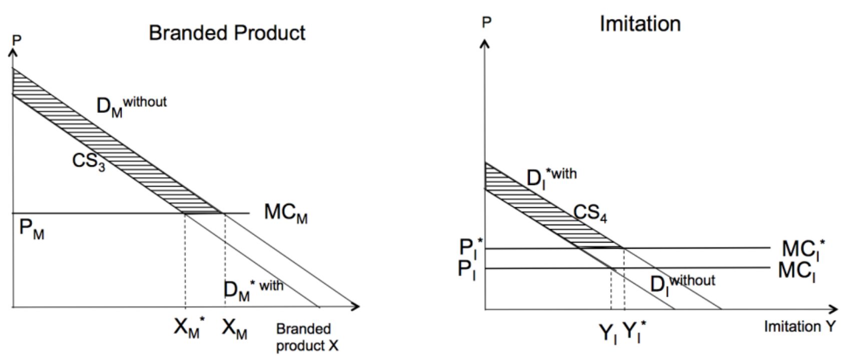

Figure 2: Markets with comparative advertising

According to the Anderson-Renault model[90] of comparative advertising, once consumers are fully informed about the two products and their qualities, the imitator will be able to shift the demand curve in the northeast direction (D_I^{*with}). The flip side of the coin is that since the trademark holder’s customers will switch to the imitation, the branded product’s demand curve will shift inward (D_M^{*with}). Ultimately, comparative advertising may create slightly higher product costs. Hence, the marginal cost curve will also shift upward (MC_I*). A higher product price P_I^* is the result. Still, this increase in costs is assumed to be

90. *See* Anderson & Renault, *supra* note 86, at 565–66.

negligible—in other words, comparative advertising will not incur much higher costs than non-comparative advertising. In the end, customers of the imitation will gain additional net benefits (consumer surplus) according to CS_4.[91] Furthermore, consumers of the branded product will realize that their expected consumer surplus CS_3 has been a sham; they have been misled by an overly optimistic expectation with regard to the branded product's features.

In summary, consumers' greater awareness of their match valuation due to comparative advertising helps improve market conditions in two ways: First, it creates higher benefits from consumption of the imitation. Second, it eliminates consumers' disappointment with the branded product. Here, it is worth pointing out that these benefits must be considered in conjunction with the potential detriment ensuing from the appropriation of a competitor's trademark and goodwill.

B. *What Is a Trademark and What Are Its Basic Functions?*

As we have seen, comparative advertising enhances marketplace efficiency and produces welfare gains if it can eliminate both the underestimation of imitations and the overestimation of branded products. At the same time, however, it may also lead to trademark-related losses. In this regard, it is important to take a closer look at the model of trademark protection based on confusion and misinformation prevention, as well as the model of property-based rights protection. The latter model in particular has been widely neglected in both scholarship and practice.

1. Misinformation Prevention (Confusion-Based Theory)

The most central and well-researched concept of trademark protection is based on the mechanics of "search-cost reduction" as first explained by Landes and Posner.[92] Essentially, this term refers to information asymmetry caused by a market failure that is overcome by the use of source and quality indicators in commercial communication. These correlations are well known to today's trademark lawyers: Without reliable information on product quality and price, consumers' search costs rise; they must spend more time and effort researching the marketplace, inspecting products, and testing products through consumption. At the same time, producers have less incentive to

91. The loss that is due to an increase in advertising expenses (if it occurs at all) is reflected in the trapezoid P_I^* (on the P axis), P_I (on the P axis), Y_I/P_I, and $D_I^{without}/P_I^*$. Under an assumption that comparative advertising will only replace an existing campaign of generic advertising, the cost increase is likely to be negligible.

92. *See* Landes & Posner, *supra* note 73, at 268–80.

produce high-quality goods and services and are more inclined to try to mislead consumers.[93] This conundrum is resolved as soon as the consumer is provided with reliable information on product quality and source. From this point on, she can use her past experiences with consuming the product to decide on future transactions in the marketplace. The instrument that is most essential to overcoming such quality uncertainty is the use of trademarks by actors on the supply side of the marketplace. It is brand goodwill and its information-accumulating and information-conveying function that allow the consumer to successfully (i.e., rationally) navigate the marketplace.[94]

At the same time, in addition to providing consumers with relevant information, the structures of trademark-based marketplace communication incentivize producers and trademark owners to continue providing products that supply positive experiences. If product quality deteriorates, consumers are motivated to alter their consumption patterns. The non-consumption of the branded product, then, is the means of retaliation for unmet expectations.[95] Economists explain this mechanism as a competitive equilibrium, where longstanding profits on the supply side of the market outweigh the additional costs incurred to establish and maintain a trademarked product.[96]

With respect to this quality-guaranteeing effect of the trademark's information functions, it is important to specify that according to Kevin

93. *See, e.g.*, *id.* at 268–70; Economides, *supra* note 84, at 525–27; Stephen L. Carter, *The Trouble with Trademark*, 99 YALE L.J. 759, 762 (1990); William P. Kratzke, *Normative Economic Analysis of Trademark Law*, 21 MEM. ST. U. L. REV. 199, 266–68 (1991); for a representative overview on the more recent literature, see also Menell & Scotchmer, *supra* note 27, at 1473, 1536–37. For an explanation of the famous market-for-lemons model underlying this conception of trademark functions, see George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488, 489–92 (1970). Much earlier, EDWARD S. ROGERS, GOOD WILL, TRADE-MARKS AND UNFAIR TRADING 20 (1914) ("If the bad could not be discriminated from the good, all would be bad.").

94. For the foundations, see again, Akerlof, *supra* note 93, at 499–500; furthermore, also, *e.g.*, Mark A. Lemley, *The Modern Lanham Act and the Death of Common Sense*, 108 YALE L.J. 1687, 1690 (1999); Stacey L. Dogan & Mark A. Lemley, *The Merchandising Right: Fragile Theory or Fait Accompli?*, 54 EMORY L.J. 461, 467 (2005); Giovanni B. Ramello, *What's in a Sign? Trademark Law and Economic Theory*, 20 J. ECON. SURV. 547, 548–51 (2006).

95. Akerlof, *supra* note 93, at 499–500. For an example of the implementation of these correlations into United States case law, see, e.g., Park 'N Fly, Inc. v. Dollar Park & Fly, Inc., 469 U.S. 189, 198 (1985).

96. Carl Shapiro, *Consumer Information, Product Quality, and Seller Reputation*, 13 BELL J. ECON. 20, 22–29 (1982); Carl Shapiro, *Premiums for High Quality Products as Returns to Reputations*, 98 Q. J. ECON. 659, 662–71 (1983); Klein & Leffler, *supra* note 79, at 618–25.

John Lancaster's consumer theory,[97] product X can be described by A (a_1, $a_2 \ldots a_n$), where a_n constitutes the product's attributes. Such attributes are defined as consumers' subjective experiences with a product—for example, the taste or smell of food or household products. In addition, consumers' experiences may concern a product's objective properties, such as its technical features. These properties taken together are explained as the quality indicator Q (q_1, $q_2 \ldots q_n$). Information on attributes and quality is accumulated and continually communicated through the trademark as the producer's market-information channel. Especially with respect to the communication of experience information that cannot readily be verified except by buying the product (e.g., with respect to experience and credence goods[98]), the use of trademarks as "experience signals" is highly cost efficient. In short, there is no cheaper or quicker way to directly transmit such information in the marketplace. By definition, comparative advertising that makes use of a competitor's trademark also utilizes the trademark channel to "transmit" information to the marketplace. Such communication may include both the attributes and the quality features of the products being compared. As we will see later, the scrutiny standard for comparative advertising requires a particularly rigorous differentiation between subjective- and objective-experience features.[99]

Finally, in order to complete the overview on the search-cost model of trademark protection, it is necessary to look at some of the more formal aspects of the concept.[100]

In the formal Landes-Posner model, the buyer of product X is confronted with the product's "full" price π. The full price π has two elements: the money price P and search costs H. The customer must pay the money price to the seller. The position of search costs H comprises costs that the consumer incurs when searching for a suitable product for her transaction and investigating the product's characteristics. The full

97. Kelvin J. Lancaster, *A New Approach to Consumer Theory*, 74 J. POL. ECON. 132, 133–42 (1966). As an overview: SAUL ESTRIN, DAVID LAIDLER & MICHAEL DIETRICH, MICROECONOMICS 260–69 (5th ed. 2008).

98. Another category comprises so-called inspection or search goods, where the consumer can discover the qualities by directly inspecting the good prior to making a purchase. For clarification of the distinction, see, e.g., Menell & Scotchmer, *supra* note 27, at 1541–42.

99. *See infra* Part IV.B.

100. Landes & Posner, *supra* note 73; for the "nearly total" influence of the Landes/Posner model, see Barton Beebe, *The Semiotic Analysis of Trademark Law*, 51 UCLA L. REV. 621, 623–24 (2004); *see also* Jerre B. Swann, *The Evolution of Trademark Economics—From the Harvard School to the Chicago School to WIPO 2013—As Sheparded by INTA and the Trademark Reporter*, 104 TRADEMARK REP.. 1132, 1132 (2014); for a modern and biting critique of the "Chicago School" trademark law and economics, see especially Desai, *supra* note 84, at 601–18.

price π is the maximum amount a consumer will pay, either as the money price (P) or as the monetary equivalent for her searching efforts (H). On this basis, simplifying the model, the first equation can be given as:

(1) $\pi = P+H(T)$.

The trademark gives a distinct clue regarding the product's source and qualities by referencing past consumer experiences. The higher the value of the trademark, which can be interpreted as being reflected in a lower level of uncertainty about expectations, the lower the consumer's search costs H. This means that the consumer's search costs can be explained as the effects of disappointment about non-existing and non-replicated experiences. If we rearrange the first equation, we can illustrate another aspect:

(2) $P = \pi-H(T)$.

Equation (2) shows that lower search costs H increase consumers' willingness to pay a higher money price. Accordingly, an actor with a trademarked product may earn the following profit:

(3) $I = P(T)X-C(X)-RT$.

P(T) represents the price for product X for a firm with a trademark, C(X) represents the production cost, and R(T) illustrates the strength of the trademark T. R is assumed to be a position of constant marginal costs.

Figure 3 illustrates the mechanics of the trademark-induced search-cost reduction model.

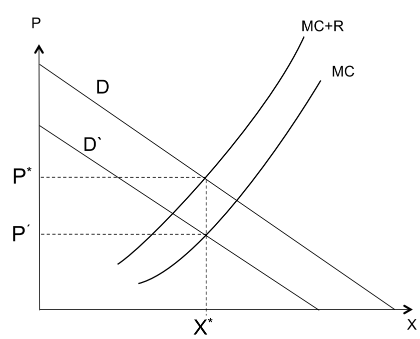

Figure 3: Search-cost model of trademark protection

D represents the demand function for a trademarked product, and D' illustrates the condition of demand for a product without a trademark (e.g., an imitation). If trademark owners are able to eliminate search costs by establishing a trademark, the money price P can be raised until it reaches the full price π. Products without a trademark, however, have a lower money price because customers must bear higher search costs. Hence, the non-branded product's demand function must be placed closer to the origin (D'). Market equilibrium prices are P' for non-trademark owners and P* for trademark owners. Still, it must be noted that the same quantity X^* will be sold in both market equilibria (i.e., in the trademarked product's and the imitation's market). Hence, it does not matter to consumers whether they pay the higher money price P^* and incur no search costs, or if they pay the lower money price P' but also incur search costs.

What is important for our legal analysis is the following: The informative function of trademarks as communication channels for consumers' product experience is the pivotal point of *any* kind of advertising communication. However, it is only if a competitor making use of generic advertising can be recognized and if competitors referred to in comparative advertising can be distinguished that the system of communication on product attributes and qualities functions efficiently. With respect to the Landes-Posner model, it is evident that if imitators can freely usurp others' trademarks, the navigation capacities and the reputation-guaranteeing function of the system are weakened and may be lost altogether. Ultimately, if trademark protection deteriorates, the system may even devolve back to Akerlof's market-for-lemons concept, with a concurrent conundrum of information asymmetry.[101]

What follows is that the prevention of consumer confusion is principally in the interest of *both* trademark owners *and* consumers. The proliferation of marketplace information—if it is truthful and correct—enhances the rationality of consumer decision-making.[102] At the same time, the accuracy of the information contributes to an efficient system of search-cost reduction with respect to trademark protection and the right owner's interest. After all, the trademark owner can raise prices toward the full price π only if consumers' search-cost ratio is optimal. In principle, there are no apparent "conflicts of interest" between the supply and demand sides of the marketplace. Thus, it is not surprising that the

101. *See* again, Akerlof, *supra* note 93, at 490–91; *see also, e.g.*, Lemley, *supra* note 94, at 1690; Dogan & Lemley, *supra* note 94, at 467; Ramello, *supra* note 94, at 548–51.

102. For limitations on the consumer's information processing capacities, see DANIEL KAHNEMAN, THINKING, FAST AND SLOW 31–38 (2011).

consumer's interest in confusion-prevention theory is rarely considered to be in opposition to the trademark owner's concerns.[103]

2. Blurring, Tarnishment, and Misappropriation (Non-Confusion-Based Theories)

The situation is different with respect to non-confusion-based trademark protection. As discussed previously, modern doctrine in Europe and the U.S. allows for protection beyond consumer misinformation, in particular for scenarios of extended trademark protection of famous and well-known trademarks.[104] In these cases, the correlation between different groups' interests—that is, right owners, competitors, and consumers—seems to represent a more complex picture. In addition, opinions on the economic underpinnings are far more diverse than with respect to the search-cost model.[105] In essence, the literature embraces a general rejection of misappropriation prevention. The old-age tenet "Trademarks are not property rights in gross" is still apodictically advanced against a property rights theory of protection.[106] As a closer look at the economic theory of property rights reveals, however, such a rejection might be premature. By contrast, the

103. See, e.g., the Senate Committee's recommendation on the Lanham Act, S. REP. No. 79-1333, at 3 (1946) ("One is to protect the public so it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well-established rule of law protecting both the public and the trade-mark owner."). The Supreme Court took this perspective of interest alignment, for instance, in *Park 'N Fly, Inc. v. Dollar Park and Fly, Inc.*, 469 U.S. 189, 198 (1985) (explaining that the Lanham Act grants trademark rights to "secure to the owner of the mark the goodwill of his business and to protect the ability of consumers to distinguish among competing producers."). For an illustrative critique of this "traditional narrative," see Michael Grynberg, *Trademark Litigation as Consumer Conflict*, 83 N.Y.U. L. REV. 60 (2008) (explaining alternatives to traditional theory on the basis of different consumer groups' conflicting interests); *see also* Desai, *supra* note 84, at 595, 615, *passim*.

104. *See supra* Part II.A.2. (U.S.), Part II.B.3. (Europe).

105. *See supra* text accompanying notes 57–60.

106. For an early mention of the tenet in case law, see, e.g., *United Drug Co. v. Theodore Rectanus Co.*, 248 U.S. 90, 97 (1918) ("The asserted doctrine is based upon the fundamental error of supposing that a trade-mark right is a right in gross or at large, like a statutory copyright or a patent for an invention, to either of which, in truth, it has little or no analogy."); *see also* Ringling Bros.-Barnum & Bailey Combined Shows v. Utah Div. of Travel Dev., 170 F.3d 449, 459 (4th Cir. 1999). For scholarly commentary, see, e.g., Kratzke, *supra* note 93, at 286; Lisa H. Johnston, *Drifting Toward Trademark Rights in Gross*, 85 TRADEMARK REP. 19, 22 (1995); Lunney, *supra* note 84; Lemley, *supra* note 94, at 1695–96; LANDES & POSNER, *supra* note 27, at 206–09; Stacey L. Dogan & Mark Lemley, *A Search-Cost Theory of Limiting Doctrines in Trademark Law*, 97 T.M.R. 1223, 1228–32 (2007); Menell & Scotchmer, *supra* note 27, at 1538, 1544; Mark A. Lemley & Mark P. McKenna, *Owning Mark(et)s*, 109 MICH. L. REV. 137, 176–77 (2010).

concept of so-called external effects, or externalities, offers a solid theoretical and practical foundation for the reconceptualization of legal doctrine in the U.S. and in Europe.

a. Foundation: Different Kinds of Externalities

The debate regarding the type of entitlements the law should acknowledge as positions of "property" has been painful and distorted throughout its history.[107] From an economic perspective, however, many of the legal arguments are dead freight. This is particularly true for questions around what constitutes "trademark property."

According to Harold Demsetz's basic definition, property rights "convey the right to benefit or harm oneself or others."[108] Since a trademark is characterized by the fact that it provides its owner with a certain decision-making power over the symbol's use in commerce—both by the owner and by others—it can be described as being akin to the Demsetzian property right.[109] Accordingly, utilization by non-owners, and the consequences that such use has on the trademark's functions and value, as well as the benefits it may confer on the non-owner user, may be referred to as external effects or externalities to a property right or entitlement.[110]

An externality is generally defined as an involuntary, non-incidental imposition of costs for third parties or as the use of a good by third parties without compensation.[111] Tibor de Sictovsky expanded on this definition by adding another, more refined distinction between

107. *See generally, e.g.*, JEREMY WALDRON, THE RIGHT TO PRIVATE PROPERTY (1988); JAMES PENNER, THE IDEA OF PROPERTY IN LAW (1997); with respect to "trademark property" furthermore, in particular, Cohen, *supra* note 31, at 815; McClure, *supra* note 84; Lunney, *supra* note 84, at 439–61, *passim*; Stephen L. Carter, *Does It Matter Whether Intellectual Property Is Property?*, 68 CHI.-KENT L. REV. 715 (1993); extensively also Spyros M. Maniatis, *Trade Mark Rights: A Justification Based on Property*, 2 INTELL. PROP. Q. 123 (2002).

108. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 347 (1967).

109. *See also* Landes & Posner, *supra* note 73, at 266.

110. For the correlation between "property rights" and "externalities," see Demsetz, *supra* note 108, at 350. For attempts to explain copyright and patent protection on the basis of externalities, see, e.g., Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 265 (2007); Jeffrey L. Harrison, *A Positive Externalities Approach to Copyright Law: Theory and Application*, 13 J. INTELL. PROP. L. 1 (2005); Alina Ng, *Copyright's Empire: Why the Law Matters*, 11 MARQ. INTELL. PROP. L. REV. 337 (2007); for an externality-based approach to trademark law, see generally David W. Barnes, *Trademark Externalities*, 10 YALE J. L. & TECH. 1 (2007).

111. *See, e.g.*, James Buchanan & Craig Stubblebine, *Externality*, 29 ECONOMICA 371, 372–77 (1962); Frischmann & Lemley, *supra* note 110, at 262.

technological and pecuniary externalities.[112] If an economic actor directly influences the production function of her competitor, the effect is called a technological externality. By contrast, if she influences the competitor's product price through marketplace competition alone, or if she causes a change in input prices, also by simple marketplace competition, it is defined as a pecuniary externality.[113] Because pecuniary externalities result from a functioning market, they are not referred to as market failures. Accordingly, economists do not see a need for interference or regulation.[114] On the other hand, situations in which technological external effects occur are seen as requiring interference by policymakers.[115] The idea, then, is to internalize externalities so that property owners are both fully encumbered with third-party costs and so that they can appropriate any existing third-party benefits. If internalization works well, the individual right owner's interests will align with the interests of society, resulting in maximum welfare.[116]

Figure 4 illustrates the concept of externalities with respect to trademark use by a non-owner imitator.

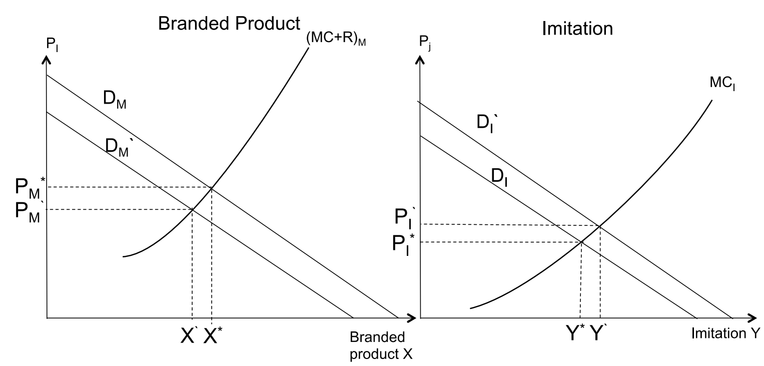

Figure 4: Negative externalities and trademark use by a non-owner imitator

112. Tibor Scitovsky, *Two Concepts of External Economies*, 62 J. POL. ECON. 143, 144–45 (1954); furthermore, e.g., Randell G. Holcombe & Russel S. Sobel, *Public Policy toward Pecuniary Externalities*, 29 PUB. FIN. REV. 304, 304–10, 313–19 (2001).

113. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, § 1.1 (9th ed. 2014); more extensively, see, e.g., Frischmann & Lemley, *supra* note 110, at 262–64; Ulrich Schlieper, *Externe Effekte*, *in* 2 HANDWÖRTERBUCH DER WIRTSCHAFTSWISSENSCHAFTEN 524 (Willi Albers et. al. eds., 2d ed. 1980).

114. *See* Scitovsky, *supra* note 112, at 149–50.

115. *See, e.g.*, Ezra J. Mishan, *The Postwar Literature on Externalities: An Interpretative Essay*, 9 J. ECON. LIT. 1, 4–9 (1971); extensively also Frischmann & Lemley, *supra* note 110, at 262–66.

116. *See, e.g.*, COOTER & ULEN, *supra* note 74, at 154–55; Frischmann & Lemley, *supra* note 110, at 265.

The graph on the left illustrates the market conditions for a branded product. The producer has invested in her trademark and, accordingly, saves her customers search costs. The branded product's demand function D_M is located in the northeast direction, equivalent to a high full price π. The trademark owner produces according to the marginal cost curve MC+R. The branded product's market equilibrium is given by price P_M^* and quantity X^*. Imitator I (in the right-hand graph) will sell at a lower money price because her customers have to bear higher search costs H. Since she does not invest in establishing and maintaining a trademark, the imitator must take lower marginal costs MC into account. The imitation's market equilibrium is given by $P_I^{'}$ and $Y^{'}$. If the imitator refers to her competitor's trademark in comparative advertising, consumers will switch from the branded product to the imitation. The imitator's demand function will then shift outward to $D_I^{'}$. The price increases to $P_I^{'}$, and the quantity of sales will be higher ($Y^{'}$ compared to Y^*). At the same time, the trademarked product's demand curve shifts to D_M', lowering the price to P_M' and the number of products sold to X'. This shift in both demand curves illustrates the positive effects of comparative advertising on consumers' respective surplus.[117] Since the change is effectuated through better consumer information and a correspondingly higher level of rationality in decision-making, this effect can be characterized as a pecuniary externality.

The analysis is more complicated, however, with respect to additional effects in the future that cannot be illustrated on the basis of Figure 4. Ultimately, the use of the trademark in comparative advertising may exert a mid- or long-term influence by watering down the trademark's distinctiveness or by lowering the owner's incentive to invest in its goodwill. Although these effects can also generally be characterized as externalities, they should be explained as dynamic rather than static. As is the case with confusion prevention, anti-dilution and misappropriation theories aim at correcting market failure. However, the failure to be alleviated does not occur *immediately* after the trademark abuse; rather, it is a failure in *future* production periods.

This reflects the correlation between models of static and dynamic efficiency. This correlation is widely acknowledged with respect to other intellectual property rights—namely, patents and copyrights.[118] In short, it reads: Only by granting the creator a certain kind of legal monopoly will sufficient incentives exist to spur innovative activities.[119]

117. *See supra* Part III.A.2.

118. *See, e.g.*, COOTER & ULEN, *supra* note 74, at 104–05; POSNER, *supra* note 113, at §§ 3.1, 11.1.

119. For a most concise explanation see, e.g., JIM LEITZEL, CONCEPTS IN LAW AND ECONOMICS: A GUIDE FOR THE CURIOUS 46–51 (2015) ("Static efficiency—optimal use of

With respect to cases of extended trademark protection, however, this correlation has been widely neglected. A closer look at the externalities at play will help overcome this deficit.

b. Clarification: The Surplus Value of Trademark Goodwill

Indeed, an externality-based analysis of extended trademark protection cases can provide the foundation for a doctrinal reconceptualization. The static-dynamic efficiency correlation indicates that only if the use of a trademark without its owner's consent can be enjoined—at least to a certain degree—will the owner have sufficient incentives to invest in the goodwill of her trademark.

With respect to misappropriation theories, it is important to remember that the trademark goodwill at issue is predominantly a "product" that the consumer wishes to acquire, independent of the underlying good or service. We are no longer talking about protecting the navigation function of a trademark's goodwill that directs and guides consumers within the marketplace. What is at stake is the trademark goodwill's surplus value beyond its primary function under the search-cost model.[120] The phenomenon is well known: Often, luxury products are bought only to signal one's social status, and not because of the actual utility of the product. In these cases, the trademark and its goodwill—in other words, scarcity, exclusivity, image, or prestige—have become commodities in themselves, dissociated from the underlying product.[121] As Frank Schechter put it almost a century ago:

> [T]oday the trademark is not merely the symbol of good will but often the most effective agent for the creation of good will, imprinting upon the public mind an anonymous and impersonal guaranty of satisfaction, creating a desire for further satisfactions. The mark actually sells the goods. And, self-evidently, the more distinctive the mark, the more effective is its selling power.[122]

Of course, this segmentation of goodwill functions and values strongly contradicts the tenet that trademarks do not provide for

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existing inventions— is sacrificed for the purpose of enhanced dynamic efficiency, the production of more inventions over time."); *see also, e.g.*, COOTER & ULEN, *supra* note 74, at 104–05; POSNER, *supra* note 113, at §§ 3.1, 11.1.

120. For the terminology of "surplus value," *see* Dreyfuss, *supra* note 31, at 402–03.

121. For an analysis of this development, see, e.g., Ramello, *supra* note 94, at 559–61; *see also* Lunney, *supra* note 84, at 466–68; Lemley, *supra* note 94, at 1695, 1713–14; Barton Beebe, *Intellectual Property Law and the Sumptuary Code*, 123 HARV. L. REV. 809 (2010). For the earliest description of the social phenomenon, see generally THORSTEIN VEBLEN, THE THEORY OF THE LEISURE CLASS (1899).

122. Frank I. Schechter, *The Rational Basis of Trademark Protection*, 40 HARV. L. REV. 813, 819 (1927).

"property right[s] in gross."[123] But marketplace realities—concretely, actual consumer preferences for products of social utility—tell a different story. And lawmakers and courts have followed suit.[124] The doctrinal foundations may be shaky, and we may rightly disagree with such an extended trademark "propertization."[125] Nonetheless, we must avoid rejecting the protection of this kind of trademark goodwill until we have more manifest and tangible proof of its actual economic, social, or other drawbacks. In any event, we should not subscribe to an *a limine* denial of relevant incentives: As dominant scholarly commentary assumes, protection against consumer confusion already suffices to create ample incentives for investment in both product quality *and* trademark value. Hence, protection of trademark goodwill beyond the trademark's navigation function, the argument goes, should be rejected.[126] Evidently, arguments of this kind would benefit from at least rudimentary empirical proof. Yet, gathering such proof may be difficult, considering the long-standing acknowledgment of so-called brand equity in marketing theory and the virtually uncontested importance of a brand's image for consumer decision-making.[127]

More important, however, is the fact that even if the incentive springing from misappropriation protection may be small, simply disregarding it fatally clouds the legal analysis. Instead, we should attempt to adopt a transparent definition, evaluation, and balancing of the interests (read: costs) involved in comparative advertising when the issue is misappropriation. An externality-based conception of trademark rights can provide the necessary framework for this more transparent and structured analysis. Although such an approach will not produce a one-size-fits-all formula for regulating market communication, it can help

123. *See* Anderson & Renault, *supra* note 86.

124. *See supra* Part II.A.2. (U.S.), Part II.B.3. (Europe).

125. For the debate see, e.g., Lunney, *supra* note 84, at 405–08, 438–39, *passim*; Lemley, *supra* note 94, at 1695–96, 1713–14 (1999); Beebe, *supra* note 121; Lemley & McKenna, *supra* note 106, at 173–74; Jeremy N. Sheff, *Veblen Brands*, 96 MINN. L. REV. 769 (2012); Desai, *supra* note 84, at 605–07, *passim*. For the historical phenomenon of "trademark property" and formalism, see DORNIS, *supra* note 9, ch. 1 and 2.

126. *See, e.g.*, LANDES & POSNER, *supra* note 27, at 208–09; Menell & Scotchmer, *supra* note 27, at 1553–54; more careful, however, Lemley & McKenna, *supra* note 106, at 176–77 ("[W]e concede it's possible that refusing to protect a mark against some uses outside the control-over-quality range . . . will somewhat reduce the incentive to invest in this brand 'personality.' But we think that whatever incentive is created by this incremental difference in scope is small . . . ."). For a similar argument in European commentary, see, e.g., Ansgar Ohly, *Blaue Kürbiskerne aus der Steiermark*, *in* FESTSCHRIFT FÜR IRMGARD GRISS 521, 526 (Brigitte Schenk et al. eds., 2011).

127. *See, e.g.*, DAVID A. AAKER, MANAGING BRAND EQUITY: CAPITALIZING ON THE VALUE OF A BRAND NAME (1991); David A. Aaker, *The Value of Brand Equity*, 13 J. BUS. STRG. 27, 28–32 (1992); Kevin Lane Keller, *Conceptualizing, Measuring, and Managing Customer-Based Brand Equity*, 57 J. MARKETING 1, 3–8 (1993).

design a more consistent and practical system of balancing relevant interests and concerns. Above all, it requires trademark use by non-owners to be regulated in the interest of providing incentives for goodwill investment. At the same time, it allows for limitations to the owner's rights whenever and insofar as the counter-balancing of benefits from static efficiency requires more leeway for competitors to reference the trademark. Under this approach, it is not necessary to internalize each and any externality.[128] Rather, the challenge is to find an optimal balance between internalizing regulation (in favor of right owners) and externalizing liberalization (in favor of third-party users and competitors).

c. Application: Trademark Protection and Cost Balancing

Based on the analysis of static-dynamic efficiency correlations, the different scenarios of trademark protection beyond the confusion-prevention model can be approached in a more nuanced light. Each case should apply a unique balancing of the interests involved and the correlated costs. By making the economic rationale transparent, it is easier to calibrate an optimal balance between internalization and externalization of the detriments and benefits of referential trademark use.

1. Blurring (whittling away, watering down)

The prevention of blurring aims at mitigating an effect of trademark use that develops over time, commencing with the defendant's dilutive trademark use. As explained earlier, the proliferating use of a famous or well-known trademark will weaken the trademark's distinctiveness over time—and in the end, consumers will no longer be able to associate the product and the brand as quickly as they once did. In economic analysis, the trademark's diminishing distinctiveness will ultimately lead to higher search costs for consumers.[129] Seen in this light, it is clear that the prevention of blurring is intended to avoid the emergence of a negative technological externality. The trademark's distinctiveness is directly affected by the competitor's utilization of the trademark; furthermore, this use also directly affects the production function of the right owner.

128. *See, e.g.*, Lunney, *supra* note 84, at 441–53; Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1046–65 (2005); Frischmann & Lemley, *supra* note 110, at 268–84.
129. *See supra* Part II.A.2.

Since the ultimate injury occurs in the future, however, this kind of externality constitutes a dynamic effect.[130]

2. Tarnishment (denigration, degradation)

Similarly, cases of trademark tarnishment involve negative technological externalities. Typical examples of tarnishment include references to a trademark in an unsavory or dubious context.[131] Furthermore, in these cases, the production function of the right owner is directly affected by an attack on the trademark's distinctiveness and appeal. Concretely, the unwanted associations generated by the defendant's conflicting use distort the information that the mark—and ultimately the owner—can convey in the marketplace.[132] Since tarnishment exerts its detrimental effects over time, it also generates technological externalities of a dynamic nature.

3. Misappropriation (free riding, parasitism)

Finally, misappropriation involves cases where a competitor makes use of a trademark's exclusivity, scarcity, or prestige. There are usually two variants: In the first variant, the competitor refers to the trademark or branded product comparatively in order to transfer the goodwill—for example, its air of exclusivity, scarcity, or prestige—to her own product. In this case, the reference is directly aimed at the trademark's "brand personality."[133] In the second variant, reference to the trademark is made simply to garner consumers' attention. This case involves a more superficial exploitation of the goodwill trading on its immediate recognition-inducing function.[134]

As illustrated earlier, both variants are viewed skeptically with respect to their economic underpinnings.[135] However, despite the scholarly hesitation and critique, legal practice continues to follow a

130. For clarification, we need to emphasize again that the risk of blurring or watering down trademark distinctiveness is not an aspect that may make comparative advertising improper under Council Directive 2006/114, 2006 O.J. (L376) 21, art. 4 (EC). *See, e.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 02, 2015, 117 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 1136 (1139 ¶ 38), 2015 (Ger.).

131. *See supra* Part II.A.2.

132. *See, e.g.*, Economides, *supra* note 24, at 601, 601–03; Robert G. Bone, *A Skeptical View of the Trademark Dilution Revision Act*, 11 INTELL. PROP. L. BULL. 187, 189 (2007).

133. *See, e.g.*, Lemley & McKenna, *supra* note 106, at 177.

134. For European (and German) law on these cases, see, e.g., Glöckner, *supra* note 47, at ¶ 489.

135. *See supra* Part III.B.2.

principle of if-value-then-right.[136] In particular, European practice after *L'Oréal/Bellure* has openly denied the need for an economic foundation of its misappropriation doctrine.[137] In the wake of this judgment, courts have provided ample protection for trademark owners and have extensively adhered to diffuse and vague categories of conduct-related unfairness. In this regard, it is important to return to the part of the *L'Oréal/Bellure* judgment that focuses on the issue of "parasitism" and "free-riding" that we have already cited in full.[138] In light of the economic underpinnings that we have illustrated, an inquiry on externalities is called for. Such an inquiry, however, is missing from the Court of Justice's reasoning. Indeed, injury to the trademark owner—in other words, "detriment caused to the mark"—is deemed irrelevant. In addition, the defendant's benefits are vaguely captured by the court's empty formula of a "clear exploitation on the coat-tails of the mark . . . ."[139]

If we examine the issue of goodwill misappropriation in light of the economic foundations, primarily with respect to static-dynamic efficiency correlations, we can see a clear structure: Above all, consumers' lack of information must be alleviated. The benefits are illustrated by the dual shift of demand curves in the economic model of comparative advertising and its functions.[140] Yet, a complete elimination of market inefficiency due to such a lack of information may not be indicated in light of the need to provide sufficient incentives for trademark owners to continue investing in trademark goodwill. Of course, one could agree with misappropriation critics in the U.S.[141] Comparative advertising, unless it is misinforming, would then always have to be understood as efficient *per se*, and no trademark protection to surplus goodwill beyond the trademark's navigation function under the search-cost model would be granted. In this case, it could also be seen as consistent to grant an across-the-board nominative fair use defense, as implemented in the Lanham Act.[142] Yet, as we will see in the next section, an externality-based analysis not only provides a more

136. *See supra* text accompanying notes 22–31.
137. *See supra* notes 63–67.
138. *See supra* Part II.B.3; Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185 ¶¶ 41, 49. U.S. law also considers such a doctrine. *See, e.g.*, Ty Inc. v. Perryman, 306 F.3d 509, 512 (7th Cir. 2002) (Posner, J.) ("Third, and most far-reaching . . . there is a possible concern with situations in which, though there is neither blurring nor tarnishment, someone is still taking a free ride on the investment of the trademark owner in the trademark.").
139. *L'Oréal*, 2009 E.C.R. ¶ 41.
140. *See supra* Part III.A.2.
141. *See supra* Part III.B.2.b.
142. *See supra* Part II.A.2.

transparent structure for decision-making but also allows for a context-specific consideration of costs and benefits of internalization through goodwill protection and externalization through referential trademark utilization.

IV. RECONCEPTUALIZATION

Many of the conundrums of the current doctrine on comparative advertising could be resolved through the adoption of a more economic approach. Such a reconceptualization also provides an economically consistent basis for many issues of market-information regulation at the intersection of trademark rights protection and unfair competition prevention.

A. *Leitmotif: Freedom of Marketplace Communication*

Our analysis of the functions of comparative advertising has revealed that product comparisons multiply the stock of marketplace information available to consumers. In an economic model of advertising, the benefit of such a proliferation of information can be explained as growth in the consumer's surplus due to the enhanced rationality of her decision-making.[143]

Viewed in this light, existing European law—with its perfume clause prohibiting imitation claims—should be interpreted skeptically. Although the courts tend to emphasize that a "restrictive" interpretation of the perfume clause is indicated,[144] the trier of fact is still left to her own devices when confronted with the judicial rules on delimiting admissible and inadmissible presentations of products as "imitations." In addition, calls for differentiating between other aspects—for example, between the types of products at issue (e.g., perfume vs. medicine)—raise more questions than answers.[145]

Obviously, the text of the directive and its implementation in member states inhibits significant diversion from the *per se* prohibition. Still, the most drastic economic distortion can be eliminated by strictly cutting back on market-information censorship. In order to avoid the pitfalls that we have illustrated, it is essential that the perfume clause and its national-level counterparts be narrowly constructed. For legal

143. *See supra* Part III.A.2.
144. For Germany, see, e.g., Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 06, 2007, 110 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 628 (631 ¶ 25), 2008 (Ger.); Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 02, 2015, 117 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 1136 (1140 ¶ 42), 2015 (Ger.).
145. For this problem, see infra Part IV.C.3.

practice, this means that only a comparison *literally* claiming an "imitation" or "replica" should be deemed inadmissible.[146]

As we have seen, this is an aspect on which European law diverges strikingly from U.S. doctrine. The American approach better incorporates the economic underpinnings of market communication. More than a century ago, Justice Holmes pointed out the relevant factors. Writing for the Supreme Court on a case regarding comparative advertising and imitations, he explained:

> But the plaintiff has no patent for the water, and the defendants have a right to reproduce it as nearly as they can. They have a right to tell the public what they are doing, and to get whatever share they can in the popularity of the water by advertising that they are trying to make the same article, and think that they succeed . . . . By doing so, they are not trying to get the good will of the name, but the good will of the goods.[147]

B. *Misinformation Prevention: A Fine Line of Subjectivity*

With respect to the risk of misinformation through comparative advertising, legal doctrine—in both Europe and in the U.S.—generally reflects the economic underpinnings correctly. Essentially, any kind of misinformation must be avoided. However, one issue must be clarified with regard to perfume comparison lists of the style "smells like . . .".

From an economic perspective, in order for a regulation of marketplace communication to be valid, it must seek to prevent misinformation. The legality of comparative advertising thus depends on whether such advertising contains measurable and verifiable information. That is, objective propositions are easier to verify and measure than subjective ones. Ultimately, a court must be able to determine the facts and make a comparison. In economic terms, this rule creates a disincentive for the use of misinformation by competitors engaged in comparative advertising.[148] Examining the negative effects of misleading advertising once more helps explain why such rigorous scrutiny is required. Let us return to the economic model: Figure 5 modifies our illustration in Figure 2 and exemplifies the demand curves and their movement for a branded product and its imitation in cases of misleading comparative advertising.

146. For the intricate rules on separating admissible claims of equivalence from inadmissible imitation claims, see *supra* Part II.B.2.

147. Saxlehner v. Wagner, 216 U.S. 375, 380–81 (1910) (Holmes, J.).

148. *See supra* Part III.A.2.

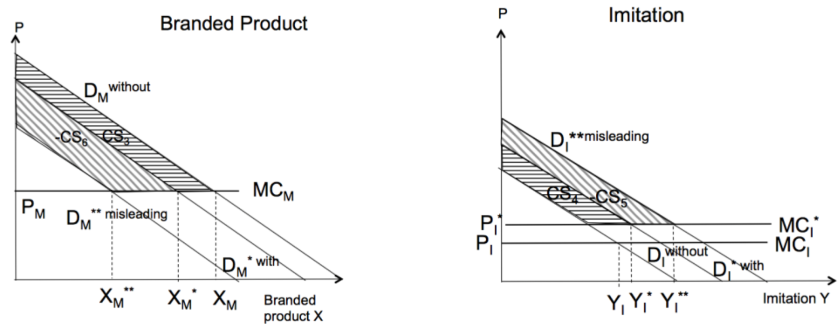

Figure 5: Comparative advertising and consumer misinformation

First, as seen in the graph to the right, the use of misleading information in comparative advertising allows the imitator to shift her demand curve in a northeast direction. Unlike truthful and non-confusing comparative advertising (D_I^{*with}), however, the imitator's demand curve will not only exceed sales without advertising ($D_I^{without}$) but also further extend sales numbers beyond the optimal stage to the new demand curve $D_I^{**misleading}$. As seen in the graph to the left, the trademark owner, as a consequence of such misinforming advertising, will revert to a status of even fewer sales than those that she had realized in the case of truthful comparative advertising (D_M^{*with}) and ultimately realize a demand function with the curve $D_M^{**misleading}$. Consumers who are tricked into buying the imitation will lose the surplus CS_5 that they had hoped to realize. In addition, they will forego any realization of a surplus CS_6 with respect to the branded product. These positions are negative and hence constitute the costs of misleading comparative advertising.

In light of these losses, it is important to point out another aspect of information economics. With respect to perfume comparisons, the distinction between attributes and qualities is essential. As we have already explained, attributes are defined as a consumer's previous experiences with the consumption of a product. However, such experiences are, naturally, subjective. Thus, it is virtually impossible to provide an objective assessment and evaluation of such subjective characteristics. Accordingly, judges and other triers of fact can rarely verify the truth of consumer experiences with respect to attributes.

On this basis, a second look at perfume imitation claims and comparison lists illustrates a problem that is still widely overlooked. It highlights exactly where legal doctrine, at least in Europe, has fallen off track. A product's scent provides for a subjective experience. It must therefore be characterized as an attribute, as it can rarely be generalized and felt identically across all members of a consumer group. Indeed, even if the imitation is truly identical to the original in its chemical composition, the "smell" may differ due to the unique circumstances of the "experience." In any event, it is impossible to verify "sameness" if the two substances do not share an identical chemical formula. Hence, unless an imitation can be claimed to perfectly imitate the original's chemical composition, a risk of misinformation exists. Accordingly, any comparison in the sense of "same," "as," or even "like" is intrinsically misleading.

Interestingly, lower courts usually recognize the correlation while higher instances tend to overlook it. In the U.S., the district court correctly considered the relevance of attributes, at least with respect to the outcome, by deciding subsequent to and on the basis of *Smith v. Chanel*.[149] There, the court explained that a claim of exact sameness could lead to misrepresentation, since such sameness was amiss:

> Compounds which do not have the identical chemical composition cannot smell precisely the same. The results of gas chromatograph tests prove that the chemical composition of "Second Chance" is not identical to that of "Chanel No. 5."[150]

The problem with European practice under article 4 of Directive 2006/114/EC is that a perfume's scent has come to be wrongly assumed to constitute a product "feature"—one that can be "objectively" compared. Therefore, a risk of misleading the consumer appears nonexistent, although the "scent" hardly provides a reliable basis for comparison. This issue is actually the greatest defect of the Court of Justice's ruling. As it explained without further elaboration:

> [I]t is irrelevant . . . whether the advertisement indicates that it relates to an imitation of the product bearing a protected mark as a whole or merely the imitation of an essential characteristic of that product such as, in the present case, the smell of the goods in question.[151]

Under this doctrine, if a perfume producer makes reference to the scent of her and a competitor's product, she is thought to be "objectively

149. Smith v. Chanel, Inc., 402 F.2d 562 (9th Cir. 1968); *see also supra* text accompanying note 14. For the subsequent district court decision see Chanel, Inc. v. Smith, No. 45647 GBH, 1973 WL 19871 (N.D. Cal. May 22, 1973).

150. *Smith*, 1973 WL 19871, at *3.

151. Case C-487/07, L'Oréal v. Bellure, 2009 E.C.R. I-05185 ¶ 76.

compar[ing] . . . one or more material, relevant, verifiable and representative features of those goods and services."[152]

National tribunals follow the same approach. A striking example can be found in German case law, where the Appellate Court (*Oberlandesgericht*) of Munich, also analyzing a case of perfume comparison lists, correctly assumed that a perfume's scent is a feature that cannot be compared objectively.[153] However, the German Federal Court of Justice, which had the last word in the case, gave short shrift to the lower court's arguments, finding a perfume's scent to be a relevant feature eligible for an objective and hence non-misleading comparison.[154]

In addition to the more specific aspect of attribute comparisons, this finding can be generalized with respect to other product characteristics. Regarding product quality, a comparison is possible using one or several of the qualities. If the features being compared are accessible to objective scrutiny, advertising on these aspects is allowed. Here as well, however, it is important to return to an economic basis because it makes a difference what kinds of products—inspection, experience, or credence—are being compared.[155] If quality features are used within an inspection or search comparison of goods, the verification problem is rarely significant because consumers can easily test and verify (or refute) the quality claim prior to consumption. Not surprisingly, such products are rarely branded. For experience and credence products, however, quality information cannot be obtained without further cost. The consumer will at least have to try the product first before she can make a reliable assessment and evaluation of its qualities. Accordingly, trademarks attached to experience and credence products should be eligible for comparative advertising only under strict conditions.

In summary, we can conclude that both European and U.S. doctrine on the comparative advertising of perfume is economically unsound insofar as a comparison of "smell" may be admitted without much scrutiny regarding the potential to mislead and confuse consumers. While a *per se* prohibition of imitation claims and comparison lists is not indicated, neither is an unrestricted reference in the sense of "smells like . . ." or "the same scent as . . .".

152. Directive 2006/114 of the European Parliament and of the Council of 12 December 2006 Concerning Misleading and Comparative Advertising, art. 4 lit c., 2006 O.J. (L 376) 21 (EC).

153. Oberlandesgericht München [OLG] [Higher Regional Court of Munich] Apr. 12, 2001, 47 WETTBEWERB IN RECHT UND PRAXIS [WRP] 820 (827), 2001 (Ger.).

154. Bundesgerichtshof [BGH] [Federal Court of Justice] Feb. 05, 2004, 106 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 607 (611, 612), 2004 (Genealogie der Düfte) (Ger.).

155. For the differentiation between inspection (search), experience, and credence products, see *supra* Part III.B.1.

C. *Is There Something Else? Issues of Dilution and Misappropriation*

Finally, with respect to cases of non-confusion-based trademark infringement doctrine, a closer look at the economic underpinnings allows for a revision of legal doctrine in several respects. In this regard, the European rule of indispensability or proportionality may actually come closer to an economically reasonable system of externality-based analysis than the Lanham Act's nominative fair use defense.[156] After all, an absolute safety haven granted to competitors in cases of comparative advertising oversimplifies the problem of misappropriation by simple neglect and, ultimately, may even distort the analysis.[157] Even though imitation claims and product comparison lists may often be found admissible under a rule of "efficient proportionality" as well, only a transparent exploration of costs and benefits can provide the foundation for rational judicial decision-making. When we talk about "efficient proportionality," therefore, we suggest a number of modifications to the current European doctrine of misappropriation prevention under *L'Oréal/ Bellure*.

1. The Standard of Objectivity or Infringer Intent Irrelevance

As we have seen, European doctrine still largely relies on a morality-based concept of misappropriation prevention. For example, the *L'Oréal/Bellure* judgment implies an understanding that actors using comparative advertising as a marketing instrument *intentionally* ride on the coattails of a successful competitor and her trademark's goodwill.[158] In scholarly commentary, the argument even seems to go so far as to imply unfairness of appropriation on the side of the competitor from the *consumer's* allegedly improper motivation. As Landes and Posner explain, "The final economic argument for anti-dilution laws" is to be found in the fact that

> [T]he confusion does not occur in the market for the trademarked good, or in any other product market, but in a "resale" market where consumers of the product compete with other consumers for advantageous personal transactions . . . . The trade-off would be simple only if we were confident that the sole motive for buying the cheap copy was to pass oneself off as having a higher income. Then one could regard the seller of the cheap copy as a kind of contributory infringer who was making it easier for consumers to

156. *See supra* Part II.B.3. (Europe), and Part II.A.2. (U.S.).
157. *See supra* Part III.B.2.b.
158. *See supra* Part II.B.3.

> deceive the people with whom they transact in the market for personal relations and sometimes in the job market as well.[159]

As our investigation into the economic underpinnings of comparative advertising has illustrated, however, an alleged infringer's intent as such is irrelevant for assessments of both misinformation and misappropriation. The distortion of marketplace information is an issue of objective effects (externalities). It does not matter whether a market actor "aims at" an illegitimate-since-undeserved profit. This is not new knowledge. On the contrary, in other areas of unfair competition and trademark law, theory and practice have come to acknowledge the limited relevance of infringer intent in general.[160] However, with respect to comparative advertising, the cart is put before the horse. This is the first aspect that requires modification.

2. Interest Balancing: A Rule of "Efficient Proportionality"

In addition to needing objectivizing, the European doctrine of proportionality requires a significant revision with respect to the identification, definition, and balancing of costs and benefits.[161] Several economization steps are in order.

First, reliance on deterioration of a trademark owner's goodwill—even if damage can actually be proven—does not suffice to find an infringement by comparative advertising. As we have seen, comparative advertising can create a beneficial increase in consumer surplus (with respect to the imitation), as well as a benefit resulting from consumers' realization that their expected surplus from consumption of a trademarked product was a sham.[162] Since both effects can be considered a correction of market failure (pecuniary externality), they should in principle not be assessed as relevant harm to the trademark owner.

Instead, a different and separate aspect of the right owner's losses needs to be given regard to. This aspect concerns what we have explained as a necessary element of static inefficiency, which is required

159. LANDES & POSNER, *supra* note 27, at 208–09.
160. *See, e.g.*, *Protection Against Unfair Competition – Analysis of the Present World Situation*, WORLD INTELL. PROP. REP. (World Intell. Prop. Org., Geneva, Switz.), 1994, at 24 ("[S]ubjective elements are therefore not essential to the notion of fairness in competition."). For the U.S., see, e.g., RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 1 cmt. c (AM. LAW INST. 1995). For the historical jettisoning of "intent" as a necessary element in an infringement action in American doctrine, see DORNIS, *supra* note 9, at 78–84. For Europe and Germany, see, e.g., JOCHEN GLÖCKNER, *UWG Einl C*, *in* KOMMENTAR: GESETZ GEGEN DEN UNLAUTEREN WETTBEWERB (UWG) MIT PREISANGABENVERORDNUNG ¶ 102 (Henning Harte-Bavendamm & Frauke Henning-Bodewig eds., 3d ed. 2013).
161. *See supra* Part II.B.3.
162. *See supra* Part III.A.2.

to provide sufficient incentives to invest in trademark goodwill.[163] Although it will be difficult to determine the optimal degree of such static inefficiency—in other words, the "monopoly" gains required to provide an adequate level of dynamic efficiency—it is important to differentiate these two elements of the right owner's losses. As is the case with respect to morality or infringer intent, therefore, neither a sweeping reference to "trademark owner losses" nor to the interest in better "consumer information" will suffice to justify a prohibition of or a complimentary ticket for comparative advertising.

In any case, we must avoid giving regard to the alleged interests of the defendant (e.g., her interest in "market entry"). These interests are already fully considered in the guise of the consumer-information concern with respect to better market information. Accordingly, we should also refrain from referring to dubious interests or empty formulas of "freedom of competition" or "freedom to trade." The balancing of static-dynamic efficiency concerns is nothing more than a quest for optimal marketplace competition. Ultimately, therefore, the analysis will come down to a comparison of costs and benefits of increased and better market information, as well as reduced incentive for the creation and maintenance of a trademark's surplus goodwill.

Finally, the European rule of indispensability as provided for in Recital 14 of Directive 2006/114/EC and further explained in *L'Oréal/ Bellure* should undergo a number of more detailed modifications.[164] As we have seen, when addressing proportionality, European courts and scholars currently tend to open the door to arguments that extend beyond economic considerations. One example of such a distorted over-extension of goodwill protection is the prohibition on the use of figurative marks and symbols: If the use of the word mark appears to suffice to transfer the necessary information, the figurative mark (as well as other graphically more elaborate denominations) should be prohibited. Ultimately, a presumption of non-proportionality and, accordingly, of unfairness prevails whenever a figurative mark is used. Another illustrative example is the use of a competitor's trademark as an eye-catcher in comparative advertising. For instance, German practice generally agrees on a rule of *per se* illegality for such use.[165]

What is overlooked under such a rule of *neminem laedere* is the fact that from an economic perspective, the specific factual circumstances of market communication should be taken into account. The figurative

163. *See supra* Part III.B.2.a.
164. For the rule and principle of indispensability or proportionality, see *supra* Part II.B.3.
165. *See* supra Part II.B.3.

mark will regularly transfer information more easily, thus contributing to a significant reduction in information cost for consumers. As seen in our economic model, more efficient information will ultimately create consumer rents.[166] A generalized limitation on the means of market communication that requires using the less "informative" OEM numbers or word marks ignores the benefits that a catchier instrument of information transmission can offer. Particularly when consumers have little time to collect and process marketplace information, use of the more informative designation should be permitted. In essence, therefore, the trademark owner's level of "tolerance" for comparative advertising through the use of her trademark—and, if necessary, her figurative mark—must be raised accordingly.

This approach can be illustrated at a practical level: In 2015, the German Federal Court of Justice held that the use of a competitor's trademark—and not just reference to her OEM or article numbers—could qualify as legitimate comparative advertising.[167] In this case, the defendant, a producer of non-branded vacuum cleaner bags, had made use of a competitor's famous trademark in her online advertising. Prior to this verdict, German practice had followed a restrictive rule of proportionality and indispensability, requiring the use of OEM or article numbers rather than the word or figurative marks of a competitor. But in this case, paying particular regard to the circumstances of online advertising and to the functioning of online search engines, the court explained that there was no evidence that "the detriment to the [trademark owner] will exceed the benefits of such conduct [i.e., comparative advertising and use of the word mark] ensuing for the defendant, the consumers, and competition as such."[168] Although the judgment still reflects a rather imprecise analysis of the aspects that should be considered relevant under an economic perspective, it is correctly founded on a concept of balancing the costs and benefits at issue—that is, the external effects on the right owner's side and the rise of consumer surplus on the other side.

3. Watch Out: No Interests Beyond Market Communication

Finally, the balancing of interests involved in the proportionality principle must be corrected in another respect. As is often implied, the number of interests that should be considered is large, and it includes

166. *See supra* Part III.A.2.
167. Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 02, 2015, 117 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 1136 (1138), 2015 (Staubsaugerbeutel im Internet) (Ger.).
168. 117 GRUR 1136 (1139).

concerns that go beyond the mechanics of market communication and consumer information. One often-articulated example is generic drugs.[169] Unlike the purchase of perfume imitations—which generally occurs with the aim of cheaply acquiring (and, hence, appropriating) the exclusivity, image, and prestige of the original brand—the purchase of pharmaceutical generics reflects much less "vanity," instead carrying a social welfare element. By more freely allowing comparisons between brand-name medicines and generics, the argument goes, costs to the public health system could be reduced.[170]

Although the objective of reducing costs in the social sector may be a venerable one, lawmakers and courts should not overlook the fact that this concern goes beyond the regulation of marketplace communication. It is actually an issue of redistribution beyond the private-law order, of which trademark and unfair competition is a part. Nevertheless, reshuffling private property rights—in other words, redistributing them—can rarely be effectively achieved by restructuring private law. On the contrary, it is an age-old tenet of economic theory that the tax-and-transfer system provides for more effective redistribution than a tailoring of the private-law regime.[171] Hence, a cost reduction for medical expenses must not be treated differently from lowering perfume prices. After all, to return to Stigler and Becker's argument, consumers' preferences are sacrosanct. Accordingly, there is no difference in dignity based on the products at issue.[172]

Consequently, in the search for an efficient solution with respect to imitation claims, one must exclusively attend to aspects of market information and communication. The only thing that matters is the interests of market participants. Focusing on policy aspects beyond immediate market communication and transaction runs the risk of distorting the mechanism of a free and non-manipulated market.

V. CONCLUSIONS

The field of comparative advertising, notably with regard to imitation claims and product comparison lists, provides an interesting object for comparative legal analysis. Contrary to expectations, American and European trademark and unfair competition law diverge significantly. More importantly, however, many aspects are still heavily

169. *See supra* text accompanying notes 67–69.
170. *Supra* notes 67–68.
171. *See, e.g.*, COOTER & ULEN, *supra* note 74, at 7–8; A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 153–62 (4th ed. 2011).
172. Stigler & Becker, *supra* note 81, at 77, 89. For the debate on the costs and benefits of advertising and branding, see Brown, *supra* note 18, at 1181 ("The nature of the satisfaction is of concern only to the moralist.").

debated and remain unclear. As a closer investigation reveals, these issues can be resolved by means of an economic analysis.

First, if we look at the economic underpinnings of comparative advertising, we can see that the European *per se* prohibition on imitation claims (and, accordingly, product comparison lists) in article 4(g) of Directive 2006/114/EC is an economically unreasonable rule. In this regard, the American doctrine under *Smith v. Chanel* is far more in line with economically rational lawmaking. In addition, regarding the risk of the misrepresentation and confusion inherent in comparative advertising, a closer analysis of advertising and trademark functions reveals an often overlooked subtlety: Because the subjective experiences of product attributes (such as a perfume's scent) cannot be reliably verified, there is a substantial risk of misrepresentation. Thus, claims of product imitation (i.e., identity) with respect to such subjective experiences must be handled restrictively. This concerns advertising that relies on claims such as "the same smell," "like . . .," and "100% identical." Moreover, with respect to non-confusion-related issues of comparative advertising, our economic analysis has challenged the "trinity" of trademark dilution—blurring, tarnishment, and misappropriation claims. As our exploration reveals, the morality-based approach to unfairness under the doctrine of pure misappropriation—applied in particular in the wake of the Court of Justice's *L'Oréal/Bellure* doctrine—is a flawed instrument for the regulation of market information. Here as well, an economic analysis helps construct a more stringent and practical guideline for determining and balancing the interests involved. What is required is a comparison of welfare gains and losses that may ensue from trademark use in comparative advertising. Against this backdrop, it also becomes evident that the American neglect of misappropriation-prevention issues in comparative advertising, as expressly implemented in the Lanham Act, is economically dubious.

Ultimately, a more economic approach has proven to be a helpful amendment to the methodological tools of comparative law. While the transatlantic divergence in comparative advertising doctrine has been a historical fact for more than a century, its persistence is somewhat surprising in light of the modern developments of convergence that have shaped the field of intellectual property and unfair competition law. Indeed, the divergence between the U.S. and Europe dramatically contradicts comparativists' concept of a *praesumptio similitudinis*. This illustrates that while traditional legal methodology may be able to explain the differences, as well as the upsides and downsides, of each system's peculiarities, only a stringent economic analysis can engender specific suggestions for ameliorating the defects in each system.