

# The Law and Economics of Trademarks in Europe

## The basic structure of European legal regulation of trademarks

- Not totally unlike patent Law, trademark Law in Europe is **multi-layered**
  - i. **National trademark systems**, with their own rules, requirements, procedures and offices, and rights for trademark holders. 2 important qualifications
    - **Registered trademark systems are very similar**: they have been heavily **harmonized at the EU level by the First Directive on Trademarks** (1988)
    - Most EU countries keep **related areas** of the Law that are **less harmonized** (if at all): **unfair competition, passing off, misrepresentation**, affecting the existence and exercise of trademarks
  - ii. The **European Union level**: Council Regulation 40/94 created a **Community Trade Mark** and a Community Trade Mark (and design) Office (**OHIM**, in Alicante), with a single procedure, unified rules, **single right and unitary effects** in and for **all member States**

**EU** also has **heavily harmonized national** trademark Law of member States through the 1988 Directive. **Substantive rules of the Directive= substantive rules of the Regulation**→ no contradiction between national trademark and Community trademark

**ECJ** has developed an **extensive and important set of precedents** interpreting the Regulation and the Directive (and through them influencing national trademark Law), and also the internal market and competition dimensions of the exercise of trademark rights

iii. **International level:**

- **Paris Union** provides for national treatment principle, protection for well-known marks even if unregistered, certain priority rights for prior foreign applications and registrations, but does not build a system of international applications and leaves national substantive rules and national offices untouched
- **Madrid Agreement and Protocol:** Create **international application mechanisms**, through which, after a national application or registration, the WIPO sends application to designated national TMO, and if they do not object within a specified time, it is nationally registered

- ☐ The 1988 **Directive** contains the **main rules common to all EU national TM systems**, and also to the **CTM**
  
- ☐ **Directive** sets the rules for **registered TM**, allowing States to keep non-registered TM protection, and also to regulate the procedural and economic aspects of TM. But the core of TM Law is subject to common rules
  
- ☐ **Requirements** for TM protection
  - i. **Registration**: TMs, in principle, have to be registered. Moreover, TM is granted to the **first to file**, not the first to use a certain sign or symbol in trade. Some exceptions→ prior use of a well-known TM defeats an application for registration
  
  - ii **Sign that refers to or can be attached to goods or services**: includes words, symbols, shapes, packaging, etc
  
  - iii. **Capable of graphical representation**: does not imply that only visually perceptible signs are acceptable→ smell of fresh cut grass accepted by OHIM as TM for tennis balls
  
  - iv. **Distinctive**: the sign is capable of distinguishing goods or services of one firm from another

- TM is **excluded** for absolute grounds
  - i. **Signs with no distinctive character**: signs that are composed of elements that describe the product and thus do not separate one brand from the other, one firm from the other. But evocative and suggestive signs are accepted, and descriptive elements if combined with non-descriptive ones → Baby-Dry case
  - ii. **Signs indicative of the origin, quality, kind, value of product**
  - iii. **Customary or generic signs** for the product as such or some of its properties
  - iv. **Functional signs**: signs (generally shapes or packages) resulting from the nature of the good, necessary to obtain a technical result or substantially valuable for the good itself
  - v. **Deceptive signs**: apt in connection with some good or service to deceive or mislead consumers
  - vi. **Contrary to public policy or of high symbolic value**
  - vii. **Bad-faith applications**: presumptive lack of intent to use is not deemed bad-faith by OHIM

- TM is **excluded** for relative grounds
  - i. **Identical to an existing TM for identical goods or services** → existing TM comprises previously registered TM, prior applications and unregistered well-known TM
  - ii. **Similar to an existing TM for similar goods or services and with risk of association by consumers** → existing TM comprises previously registered TM, prior applications and unregistered well-known TM
  - iii. **Identical or similar to an existing reputed TM** and would tarnish the reputed TM or take unfair advantage of its reputation without due cause
  - iv. **Conflict with earlier non-TM rights** → copyright, patent, name, design
  
- **Rights** conferred by the TM → TM owner has the right to authorize or prevent use in commerce (manufacturing, advertising, selling) of signs
  - i. **Identical for identical goods or services**

- ii. **Similar for similar goods or services, and with likelihood of confusion, including risk of association by consumers**
- iii. **Identical or similar, for any kind of good or service, if TM is a reputed TM** and use would tarnish or take unfair advantage of reputation without due cause
- iv. **No fixed term of protection?**

☐ TM protection **does not cover**

- i. **Use of name and address**
- ii. **Indications** of quality, origin, kind or other **characteristics** of good or service
- iii. **Use of TM** when **necessary to indicate purpose** of complementary product or service
- iv. **Tolerated infringing uses** lasting **5** consecutive **years**

☐ **TM** protection is **exhausted**

- i. For goods **voluntarily put on the EEA market**
- ii. **No exhaustion** of TM rights if put on the market **outside the EEA**, unless import had been expressly consented to

iii. **Parallel imports involving repackaging** from EEA can be opposed by TM except when it involves artificial partitioning of the internal market, no adverse effect to Tm owner, and adequate notice and information to consumers

☐ TM right is subject to **revocation**

i. **Non-use for 5 years** after registration unless justified

ii. TM has become **generic**→ common term for product or service

iii. TM is **likely to mislead consumers**→ includes cases of **assignment** or license **in gross** (per se allowed) in which the circumstances imply that consumers may be confused about quality or origin of product

## Economics of European trademark protection

- **Characteristics of goods and services** can be divided (Nelson) into
  - i. **Search characteristics** → can be determined by prospective consumer before purchase, maybe at a cost
  - ii. **Experience characteristics** → cannot be determined by prospective consumer before purchase, the good must be purchased and used before characteristics can be evaluated
  - iii. **Credence characteristics** → cannot be determined by consumer before or after purchase and consumption of the good
  
- Basic economics of TM protection → exclusive TM rights have 2 major (positive) functions
  - i. **Reduce search costs to consumers** → allow consumer to identify the producer of a given brand of good or service, and thus use in the search process the past experience (or other experience, real or imaginary) with the same brand → **substitutes for more costly ways of search for desired products or services**

- ii. **Signal a consistent level of quality to consumers** → to benefit from the search reducing qualities of TM, producers have to maintain consistent quality, both along temporal and spatial dimensions. If not, consumers will associate the TM with a bad experience, and profits will be reduced. Moreover, if quality is not maintained, investments in making TM recognizable to consumers will be lost. **If past and current consumption are not mutually consistent** in terms of consumers' utility, TM loses its value → **consumers do not trust TM as a signal of future quality**

☐ Both **economic functions require legal protection** of an **exclusive nature** → only TM owner could use or authorize use of TM. If anyone could use the TM

- i. **TM loses its search reducing properties**, because consumers cannot economize on search using TM as link between past consumption and present choice
- ii. **TM loses quality signalling function**, because consumers will not believe in TM as guarantee of consistent quality
- iii. **Producers lack incentives to invest** in backing and promoting TM → it does not pay to keep consistent quality and to advertise TM

- Both basic economic roles of TM are **mutually reinforcing**→
  - i. **the more consistent the quality**, the less costly it is for a brand producer to back a strong and popular TM, so the more recognizable the TM and thus the greater the reduction in search costs
  - ii. **the bigger the impact in search costs**, the greater the potential effect of TM and thus the incentives to make it a signal of consistent quality and to back it with quality investments
  
- There is some **empirical evidence** about the basic economic roles of TM: Png and Reitman 1995. Use of **TMarked brands** is **more likely**
  - i. The **less verifiable quality** before purchase
  - ii. The **less attractive** and the more costly is **personal search** and testing by consumers
  
- Apart from the basic economic functions, some mention also
  - i. **Incentive to create new words** or symbols that enrich our vocabulary or our imagery

- ii. **Facilitate persuasive advertising** through widely known and catchy terms as TM→ dubious in terms of social welfare: making persuasive advertising more effective does not necessarily increase social welfare
- Clear **correlation** between use of **TM** and **advertising**
- i. **Advertising expenditures tend to act as signal of product quality**→ high-quality firms expect repeat purchases due to the good consumption experience. Low-quality do not. There is a level of advertising that the high-quality would find profitable and the low-quality would not, sending an implicit signal of high quality
  - ii. **Advertising to sales ratio** (the common index for advertising) depends
    - **Positively on the advertising elasticity** of demand→ how responsive demand is to the level of advertising
    - **Negatively on price elasticity** of demand

- The synthesis is the **Dorfman-Steiner formula**, where  $a$  is advertising level,  $R$  is total revenue,  $\eta$  is advertising elasticity and  $\varepsilon$  is price elasticity

$$\frac{a}{R} = \frac{\eta}{\varepsilon}$$

- iv. Dorfman-Steiner formula does not imply that in monopolistic market structures there will be more advertising → **advertising** to sales ratio are presumably **lower for highly concentrated** and for **totally competitive** market structures

☐ **TM Law seems in general consistent with the basic economic function** of TM

- i. **Requirements for TM** protection emphasizing **distinctiveness** and ability to distinguish the goods and services from one brand from another
- ii. **Exclusion of generic** and **common** terms, **functional** signs → not necessary to communicate effectively with consumers, but increasing competitors costs to communicate

- iii. **No fixed term** of protection → no deadweight loss caused by TM protection
  - iv. **Protects** right holder only **against** acts that may cause **confusion to consumers** or may **reduce the incentive to invest in high-quality** (congestion effect or tarnishment)
  - v. Some **restrictions on transfer** of TM (US>EU) → preserving the incentive to invest in consistent quality and to reduce consumers' costs
  - vi. **Requirement to use** TM → TM only play a positive role when effectively used to identify brand producer. Non-used TM strategically raise barriers to entry for competitors or are hold-up weapons
  - vii. **Revocation** of TM when becomes **generic** → loses identification force and raises rivals' costs. But
- **Acquired generic** status is normally due to a **previous patent** (or monopoly status for other reasons) belonging to TM holder. Unclear whether patent-TM leverage is socially desirable
  - **Parchomovsky and Siegelman** model of patentee with TM

## Model

a) Single period choice

Patentee with a perfect patent for the whole period

Linear demand:

$$P = a - b Q$$

and constant marginal cost:

$c$

We have the standard monopoly equilibrium

$$P = a - b Q$$

$$M_gR = a - 2b Q$$

$$Q1^* = \frac{a - c}{2b}$$

$$c = a - 2b Q \Rightarrow$$

$$P1^* = \frac{a + c}{2}$$

b) Two-period and perfect competition in second period

b.1) Patentee gets no TM protection in second period (after patent has expired) because it is deemed generic→

Price for all firms will be  $c$  in second period,  
 $P_c = c$ .

Patentee, expecting zero profit in it,  
maximizes profit in first period as if it was  
the only period  $\Rightarrow$

$$Q1^* = \frac{a - c}{2b}$$

b.2) Patentee keeps TM and there is brand loyalty  
due to consumers switching costs

Consumers face a cost  $m > 0$  to switch from the  
patentee to a competitor if they had bought from  
patentee in period 1  $\Rightarrow$  ex-patentee can charge:

$$P_{c+m}$$

Expecting profit in the second period, the  
patentee maximizes profit over both periods:

$$\Pi = (a - b Q1)Q1 + (P_{c+m})Q1$$

Again equating  $M_gR$  to  $M_gC$ ,

$$c = a - 2b Q1 + m \Rightarrow$$

$$Q1^{**} = \frac{a - c + m}{2b} > Q1^*$$