A COMPLEMENTARY EXISTENCE: AN ECONOMIC ASSESSMENT OF THE TRADEMARK AND COMPETITION LAW INTERFACE IN THE EUROPEAN COMMUNITY

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I. INTRODUCTION

When appropriately tailored, trademark and competition laws exist as complementary interests pursuing a single objective—the advancement of market competition as an economically meaningful regulatory system.[1] However, trademark and competition laws promote market competition through very different mechanisms. For their part, trademark laws seek to initiate market competition by creating monopoly rights. Competition laws, on the other hand, work to achieve the same goal, but by restricting the ability of economic actors to obtain and abuse monopoly power. The divergent approaches through which trademark and competition laws promote market competition has traditionally led to tension at their interface. This tension has been especially pronounced in Europe where national trademark laws have had to be reconciled with the free movement principles of the Treaty of Rome,[2] a task which has thus far fallen primarily on the European Court of Justice.[3]

This Article examines how the European Court of Justice has set the terms of the trademark and competition law interface in Europe.[4] The Article begins with an introduction to the economic character of

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1. *See* Michael Lehmann, *Property and Intellectual Property—Property Rights as Restrictions on Competition in Furtherance of Competition*, 20 IIC 1, 7 (1989).

2. *See generally* Articles 3(f), 30, 36, 85, 86, and 222 of the Treaty Establishing the Economic Community (Single European Act version), 1987 O.J. (L 169) [hereinafter EEC Treaty].

3. To date, the Community legislature has provided member states with only limited guidance as to the future status of the relationship between intellectual property rights and Community competition law. The Community Legislature has, however, undertaken two major initiatives relative to trademark law. The first initiative, Council Directive 89/104 of December 21, 1989, 1989 O.J. (L 40/1), directs Member States to approximate their national trademark laws. *See* James E. Rosini & Christopher C. Roche, *Trademarks in Europe 1992 and Beyond*, 19 AM. INTELL. PROP. L. ASS'N Q.J. 213, 214-20 (1991); *see also* Mario Franzois, *Report on the New Trademark Law in Italy*, 6 EUROPEAN INTELL. PROP. REV. 220, 220-22 (1993); Christopher J. Mesnooh, *France's New Trademark Law*, 20 INT'L BUS. LAW. 477, 477-79. The second initiative, the Council Regulation on the Community Trademark, 1984 O.J. (C 230/1), has not yet been adopted due, in large measure, to political posturing among the Member States. *See* Thomas A. Larkin, *Harmony in Disarray: The European Community Trademark System*, 82 TRADEMARK REP. 634, 647-50 (1992); Rosini & Roche, *supra* note 3, at 221-28. *See* Jan Corbet, *Symposium on U.S.-E.C. Legal Relations: The Law of the EEC and Intellectual Property*, 13 J. L. & COM. 327, 367 (1994) ("Under the proposed regulation, marks will be registrable for services and goods and the constitution of a mark will be defined in detail.").

4. In its First Report on Competition Policy, Comp/1, April 1972, the European Commission noted that the reconciliation of national property rights with Community competition law should be one of the priorities of the Court.

trademarks in contemporary markets and then turns to a consideration of competition law in the European Community. In Section Four, the parameters of the trademark and competition law interface debate are defined with a general overview of competing outlooks. In Section Five, the Article examines how the competing outlooks have fared under the scrutiny of the European Court of Justice. The Article then concludes with a critical assessment of the European Court of Justice's approach to the trademark and competition law interface by arguing that its future decisions should reflect a deeper appreciation for the pro-competitive effects of trademarks.

II. TRADEMARKS AND ECONOMIC THEORY

A "trademark" is commonly defined as a word, design, symbol, or other indicia that is used to distinguish the goods or services marketed and sold by one firm[5] from the goods or services marketed and sold by the firm's competitors.[6] Manufacturers, distributors, and merchants apply trademarks to their goods and services to represent them as their own. Consumers rely on the source and product information conveyed by trademarks to assist them in their efforts to identify those products and services that most closely approximate their needs and tastes. This market dynamic has made the trademark system one of the primary mechanisms—second possibly only to pricing strategies—through which competition manifests itself in market economies.[7] The following consideration of the market conditions that led to the commercial development of trademarks, their function, and a trademark system's competitive impact on a market economy provides

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5. I use the terms "firm" and "undertaking" interchangeably to refer to a manufacturer, distributor, or merchant of goods or services.

6. *See, e.g.*, W.M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 266 (1987).

7. *See* W.R. CORNISH, INTELLECTUAL PROPERTY: PATENTS, COPYRIGHT, TRADE MARKS AND ALLIED RIGHTS 393 (2d ed. 1989) (Trademarks are "nothing more nor less than the fundament of most market-place competition."), *quoted in* Opinion of the Advocate General, S.A. CNL-Sucal NV v. Hag GF AG, Case C-10/89, [1990] 3 C.M.L.R. 571, 583.

The central role trademarks play in the commercial development of market economies stands in marked contrast to their minor, almost imperceptible, impact on command and control economies. However, the importance of trademarks in socialist countries has increased as state management of industry and commerce has declined. *See* Vito Mangini, *Competition and Monopoly in Trademark Law: An EEC Perspective*, 11 IIC 591, 592 (1980).

a point of reference for subsequent discussion concerning the interface of trademark and competition law in the European Community.

A. *Historical Foundations*

The evolution of modern trademark systems, along with the other forms of intellectual and industrial property, coincided with the institutionalization of market economies in Europe and the United States during the eighteenth and nineteenth centuries.[8] However, the advent of market economies offers only a partial explanation for the economic importance presently associated with trademarks. For example, one can imagine a market economy in which trademarks would have slight social value and utility, or perhaps none at all.[9] In their search for additional clues, commentators turned their attention to the advances in technology and communication which followed the introduction of market economies in the West.[10] What they discovered is that

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8. For a comprehensive discussion of the historical foundations of trademark law, see F.I. SCHECHTER, THE HISTORICAL FOUNDATIONS OF THE LAW RELATING TO TRADEMARKS (1925) and Sidney A. Diamond, *The Historical Development of Trademarks*, 65 TRADEMARK REP. 265 (1975), *reprinted in* 73 TRADEMARK REP. 222 (1983).

9. Assume, for example, a self-contained economic system which has three firms each manufacturing a product produced by the same chemical formula. If the product distributed by each manufacturer is of equal quality, the legal protection provided to trademarks may produce unnecessary costs to society as one firm's efforts to increase its market share through advertising cancels out another's. In the alternative, if the advertising of one firm proves to be so effective that consumers irrationally choose to purchase that product over identical substitutes, the remaining firms may be forced out of the market leaving the firm which was successful in its advertising in a dominant position.

Other forms of intellectual and industrial property which serve as an impetus to innovation, e.g. patents, may still deserve legal protection within an identical market structure. For instance, if a new and more efficient method of producing an already popular generic product could be developed with additional scientific research, firms would have little incentive to invest resources in the discovery of that process without being guaranteed a return on their investment. For in the absence of a patent right, "an improvement in a manufacturing process might occur by accident or by trial and error, but no 'research' would be undertaken as long as the benefits from such an improvement were immediately available to all other manufacturers and the costs of research were greater than that manufacturer's private gain from it." *See* Lehmann, *supra* note 1, at 9 n.17 (quoting D.C. NORTH, A NEW ECONOMIC HISTORY FOR EUROPE 154 (1968)).

10. Commentators have often cited the development of systems of mass production and distribution as the predominant, if not only, factor that led to the commercial expansion of trademarks. *See, e.g.*, David C. Wilkinson, *The Community Trade Mark Regulation and Its Role in European Economic Integration*, 80 TRADEMARK REP. 107, 107-08 (1990). The argument overlooks the importance of a market system with consumer sovereignty. In the absence of such sovereignty, systems of mass production and distribution would continue to

trademarks owe much of their success to the systems of mass production and distribution that characterized commercial development during the Industrial Revolution and altered the competitive environment in which firms had previously existed.[11]

Specifically, with increased standardization and consistency among products as well as increased competition from distant rivals, firms could no longer rely on their reputations, local patronage, or established buyer-seller relationships to maintain or increase their market shares.[12] Instead, it became necessary for firms to find ways by which they could differentiate the quality and product features of their goods from those of their competitors, as well as to provide consumers with a means of identifying their products in the future. Trademarks offered actors at each level of the competitive chain (manufacturers, distributors, and merchants) an efficient and relatively low-cost method of conveying this information and therefore became commercially relevant.

B. A Trademark's Function in a Consumer-Oriented Economy

To understand the importance of trademarks to market competition, it is also essential to consider a trademark's function: to impart to the consumer information about the commercial origin of the goods to which they are attached.[13] Historically, source information was thought to have economic value only if it identified the manufacturer of a product for the consumer.[14] This conception of trademarks was problematic because although some marks might convey information about the identity of a manufacturer, many provide information about their commercial origin by distinguishing the quality and product features of the goods to which they are attached. The

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exist, but trademarks would be irrelevant. *See supra* note 4 (discussing the role of trademarks in a command and control economy).

11. *See, e.g.*, Nicholas S. Economides, *The Economics of Trademarks*, 78 TRADEMARK REP. 523, 527 (1988); Lehmann, *supra* note 1, at 7-8; Mangini, *supra* note 7, at 591; Wilkinson, *supra* note 10, at 108.

12. *See* Basile, S.p.A. v. Francesco Basile, 899 F.2d 35, 37 (D.C. Cir. 1990).

13. The literature on trademarks displays a recent tendency among commentators to confuse the function of a trademark—to convey source information—with the economic impact of a trademark. Trademark functions have thus been described as including not only a source or origin function, but also, for example, a quality function and publicity function. *See, e.g.*, Wilkinson, *supra* note 10, at 109-10.

14. *See, e.g.*, Anti-Monopoly, Inc. v. General Mills Fun Group, Inc., 684 F.2d 1316 (9th Cir. 1982).

economist Nicholas Economides offers the following explanation for this dynamic:

> The economic role of the trademark is to help the consumer identify the unobservable features of the trademarked product. This information is not provided to the consumer in an analytic form, such as an indication of size or a listing of ingredients, but rather in summary form, through a symbol which the consumer identifies with a specific combination of features. . . . The trademark identifies both quality and variety features of the product, i.e., both features like freshness, more of which is desirable by all, and features like sweetness, over which consumers have varying preferences, some preferring little of it, and some desiring lots of it.[15]

The kind of information relevant to a consumer's purchasing decision is, in many instances, a function of the nature of the product being purchased.[16] Consumers will, for example, pay little regard to the source information conveyed by a trademark when they are purchasing goods that they have previously consumed. In these instances, the consumer is motivated to purchase a particular item not because it was made by a particular manufacturer but because he anticipates that the product's features will meet his personal requirements for quality and variety. On the other hand, a consumer who is contemplating the purchase of a product with which he has little or no experience cannot refer to his knowledge of the product for assistance. Instead, the consumer must turn to his knowledge about the manufacturer of the product under consideration.[17] Accordingly, as a consumer's experience with a product declines, the consumer will rely more heavily on the source information conveyed by the trademark.[18]

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15. Economides, *supra* note 11, at 526-27.

16. *See id.* at 530-31.

17. *Id.*

18. Contrast, for example, the process of purchasing ice cream with the process of purchasing an automobile. Unlike ice cream, a consumer's experience with automobiles is, in most instances, limited to a relatively small number of makes or models. When considering the purchase of a new car, a consumer will rely heavily on whether he believes that a particular manufacturer has a reputation for the product qualities that he seeks. Thus a consumer interested in safety may regard automobiles manufactured by Volvo more favorably than cars manufactured by Ford, whereas a consumer interested in luxury may be more interested in

Consumers enjoy substantial economic benefits when sellers use trademarks to differentiate their products. First, and foremost, trademarks reduce the search costs for consumers by providing them with a simple method for identifying products that satisfy their needs and tastes.[19] Secondly, trademarks set the stage for vigorous competition among firms through effective competitive merchandising. The reduction in search costs and the development of competitive merchandising provide manufacturers with an incentive to maintain quality standards:

> In other words, trademarks have a self-enforcing feature. They are valuable because they denote consistent quality, and a firm has an incentive to develop a trademark only if it is able to maintain consistent quality. To see this, consider what happens when a brand's quality is inconsistent. Because consumers will learn that the trademark does not enable them to relate their past to future consumption experiences, the branded product will be like a good without a trademark. The trademark will not lower search costs, so consumers will be unwilling to pay more for the branded than for the unbranded good. As a result, the firm will not earn a sufficient return on its trademark promotional expenditures to justify making them. A similar argument shows that a firm with a valuable trademark would be reluctant to lower the quality of its brand because it would suffer a capital loss on its investment in the trademark.[20]

Similarly, a firm's investment in a trademark and the subsequent acquisition of goodwill provides the firm with an incentive to engage in innovative activity.

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manufacturers such as BMW or Mercedes Benz. Ice cream, on the other hand, affords a consumer many opportunities to experience the product, due to the frequency of purchases by the consumer.

19. *See* W.T. Rogers Co. v. Wendell R. Keene, 778 F.2d 334, 338 (7th Cir. 1985) ("The purpose [of a trademark] is to reduce the cost of information to consumers by making it easy for them to identify the products or producers with which they have had either good experiences, so that they want to keep buying the product (or buying from the producer), or bad experiences, so that they want to avoid the product or producer in the future.").

20. Landes & Posner, *supra* note 6, at 270.

C. *Trademarks and Market Competition*

From an economic perspective, the legal protection provided to trademark owners is justified only to the extent that it promotes overall competition. For trademarks to serve their competitive function, a trademark owner must have the ability to preclude his competitors from using the same or a confusingly similar mark on their goods.[21] Without a perpetual monopoly, free-riding competitors would be able to capture a portion of the profits associated with strong trademarks because consumers will assume (at least in the short run) that the products distributed by the free riders were, in fact, distributed by the trademark holder.[22] In the long run, trademarks would lose their value altogether as consumer awareness of the inability of trademarks to convey reliable information increased. Firms would then quickly abandon their trademarks because the costs of developing, promoting, and maintaining them would outweigh their economic return. The existence of trademarks thus presupposes an enforceable property right.[23] Nonetheless, while conceding that trademarks provide some welfare gain by reducing consumer search costs, trademark critics argue that the monopolistic character of a trademark offsets any pro-competitive effects derived from their use.[24] Prior to considering the European Court of Justice's treatment of the trademark and competition law interface, it is therefore necessary to consider the possible anticompetitive effects of trademark protection.

1. Trademarks as a Source of Market Power

Economists theorize that scarce resources are allocated most efficiently in a competitive market where consumption demands dictate production. When a single firm, or a firm acting in concert with others, is able to raise prices above those that would exist in a competitive market, consumers will arguably suffer a welfare loss as scarce resources are redeployed without regard for consumer preference.[25] A

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21. *Id.*

22. *Id.* at 269-70.

23. *See* Friedrich-Karl Beier, *Trademark Conflicts in the Common Market: Can They Be Solved by Means of Distinguishing Additions?*, 9 IIC 221 (1978).

24. *See, e.g.*, Mangini, *supra* note 7, at 595.

25. *But see* F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 470-71 (3d ed. 1990).

course of conduct that does not take account of competitive restraints can occur over a nontransitory period only if a firm or combination of firms exercises market power. Thus, in assessing the competitive impact of trademark protection, the debate has properly focused on the extent to which a trademark can be used as a device for obtaining market power.

Some critics argue that trademarks distort competition and create monopoly prices by providing trademark owners with the means through which they can regulate the circulation of their products on specific terms.[26] Proponents of this view point to: (1) the policing function that trademarks serve in manufacturer-distributor contracts where the distributor's ability to consume a product is restricted;[27] (2) the restrictions on intrabrand competition and the free movement of goods that arise from such contracts; and (3) the fact that under certain circumstances, reductions in intrabrand competition can facilitate cartel-like behavior among manufacturers and merchants.[28]

The appeal of this argument depends, in large measure, upon the values accorded the economic effects of vertical price and nonprice restraints. The United States Supreme Court, for example, supports the position that the increased interbrand competition and the discouragement of free-riding that follows from vertical nonprice restraints offset any competitive distortions created by a reduction in intrabrand competition and limitation on the free movement of goods.[29] Vertical price restraints, on the other hand, have been received less favorably. The Supreme Court has reasoned that such restraints present a greater danger to overall competition by increasing the ease with which firms can engage in cartel-like behavior. This approach to vertical price and nonprice restraints reflects antitrust value assessments in favor of preventing output restraints and promoting profit maximization and against, for example, the free movement of goods. Setting aside the merits of such value preferences, it is worth noting that value choices are an issue properly considered as a matter of competition law and bear only tangentially on trademarks. In

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26. *See* Mangini, *supra* note 7, at 597-99.

27. These contracts commonly take the form of price maintenance agreements, exclusive dealing agreements, and agreements against parallel imports.

28. The likelihood of collusion among manufacturers is thought to increase because, at least with vertical price restraints, a manufacturer will have little incentive to cheat since its retailers could not pass on lower prices to consumers.

29. *See, e.g.*, Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988).

other words, the ability of trademarks to generate vertical price and nonprice restraints is too insignificant to offer a persuasive argument against trademarks generally.

A second concern commonly expressed by trademark critics is that trademarks lead to perception advertising. According to proponents of this argument, perception advertising distorts competition by deflecting sales from lower-priced substitutes of equal or greater quality by differentiating products in the eyes of a target audience solely on the basis of a perception.[30] Proponents further argue that perception advertising can, at best, lead to a loss in consumer welfare through excessive competition and, at worst, monopoly rents.[31] In a closely related debate, trademarks are also blamed for distorting competition by creating barriers to entry through brand loyalty.[32] Under this theory, trademarks are equated with market power in that brand loyalty may become so persuasive that new entry into the market is deterred because of the difficulties associated with promoting a new trademark in an effort to attract market shares.

The two arguments carry the greatest weight when viewed in the context of specific market structures and conditions. For example, the danger of perception advertising undoubtedly increases in the context of goods produced by an identical formula that can be readily repeated by all manufacturers in the product market (e.g. bleach). However, even in this context, the argument is not overly persuasive:

> The fact that two goods have the same chemical formula does not make them of equal quality to even the most coolly rational consumer. That consumer will be interested not in the formula but in the manufactured product and may therefore be willing to pay a premium for greater assurance that the good will actually be manufactured to the specifications of the formula.[33]

Stated plainly, for perception advertising to be successful, there must be a measure of truth in the perception.

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30. *See* Economides, *supra* note 11, at 532-35.
31. *Id.*
32. *Id.*
33. Landes & Posner, *supra* note 6, at 275.

Similarly, the argument that trademarks create barriers to entry has some validity when applied in the context of an oligopolistic market. Indeed, many economists accept the notion that strong trademarks in an oligopolistic market structure may allow the market structure to remain oligopolistic for a longer period of time than it would if trademarks did not exist.[34] However, it is unlikely that the structure of the market itself can be attributed to trademarks rather than a general market failure. Moreover, in a relatively competitive market, the argument carries little weight because goods are subject to competition from all sides.[35]

2. A Critical Assessment of the Anti-Competitive Effects of Trademarks

Proponents and critics alike accept the proposition that trademarks have the capacity to reduce consumer search costs. It is also generally accepted that mere ownership of a trademark will not lead to market power or dominance.[36] The arguments proffered against trademark protection are thus most persuasive when considered in the context of specific market structures or conditions. When an oligopolistic market structure exists, for example, trademarks have the potential to fortify that structure by discouraging new entrants. Also, trademarks, when used in connection with a vertical price or nonprice restraint, make enforcement of such contracts easier. However, outside the context of specific market conditions, the potential anticompetitive effects of trademarks are limited. Trademarks should therefore be viewed as a secondary consideration within the broader issue of how to correct or regulate specific market distortions through competition laws. With these lessons of trademark economics in mind, it is appropriate to consider the competition law backdrop in which trademarks operate in the European Community.

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34. *See, e.g.*, Economides, *supra* note 11, at 535-37.

35. *See* C.W.F. Baden Fuller, *Economic Issues Relating to Property Rights in Trademarks: Export Bans, Differential Pricing, Restrictions on Resale and Repackaging*, 6 EUROPEAN L. REV. 162, 164-68 (1981).

36. *Id.* As Professor Fuller notes, the one exception may be Realemon for artificial lemon juice.

III. COMPETITION LAW IN THE EUROPEAN COMMUNITY

Competition is valued in market economies because it is thought to provide society with productive and allocative efficiencies. However, for a variety of reasons,[37] a state of perfect competition is no more than an ideal towards which market economies strive. Competition laws were developed, in part,[38] to correct or at least minimize the competitive distortions and restrictions that are inherent in all real-world markets. They accomplish this task by defining "the rules of the game by which competition takes place."[39] Competition laws thus have an obvious impact on how trademark rights are exercised.

A. The Market Integration Ideal

The substantive provisions of competition law in the European Economic Community are embodied in its founding treaty. The Community, itself, was established to promote economic development and integration, forge political links, and to solidify newly established democratic institutions among the nation states of Western Europe.[40] Prior to the EEC Treaty, trade and economic development inside Western Europe after World War II had been hampered by artificial government barriers and private restraints on competition. Similar market distortions led to the economic and political balkanization of Europe prior to World War II and were considered among the major contributing factors which prompted that conflict. Market integration was considered a practical, though controversial, solution.

To attain their goal of market integration, participating nations agreed that goods, services, capital, and people would be free to travel

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37. Among the most often cited reasons for imperfect competition are: irrational consumers; imperfect information exchange; government intervention; rapidly changing technology; shifting consumer preference; as well as the costs imposed by other values considered important by society. *See* PHILLIP AREEDA & LOUIS KAPLOW, ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES 13 (4th ed. 1988).

38. *See* LOUIS B. SCHWARTZ ET AL., FREE ENTERPRISE AND ECONOMIC ORGANIZATION: ANTITRUST 40 (6th ed. 1983) ("The question whether the antitrust laws should serve only the goal of economic efficiency . . . , or should encompass a broader range of objectives . . . , is a fundamental one in antitrust jurisprudence.") (and citations therein); *see also* Eleanor M. Fox, *The End of Antitrust Isolationalism: The Vision of One World*, 1992 U. CHI. LEGAL F. 221, 225-27 (1992).

39. AREEDA & KAPLOW, *supra* note 37, at 13.

40. *See* GEORGE A. BERMANN ET AL., CASES AND MATERIALS ON EUROPEAN COMMUNITY LAW 838 (1993).

across borders and gain access to markets free from public and private restraints or coercion.[41] The Member States further agreed that, in order to secure the free movement of goods, services, capital, and people, governments would have to obligate themselves to eliminate public barriers to trade[42] and to adopt a common competition policy.[43]

B. The Legal Framework

In light of its unique economic and political history, the European Community sets the terms of competition from a different perspective than antitrust law in the United States. The Common Market's focus on the fundamental principle of free movement of goods and services and its willingness to use competition law as a direct, rather than indirect, method of social regulation fundamentally distinguish its approach to competition law from that of the United States.[44] Whether this approach is the most effective method of achieving market integration or even an effective way of structuring competition is a matter of much dispute and beyond the scope of this discussion. However, to appreciate the European Community's approach to trademarks, it is necessary to examine the substantive provisions of its competition policy.

The yardsticks for determining whether a particular course of conduct is acceptable under Community competition policy are contained in Articles 85 and 86 of the EEC Treaty. Although addressing different legal issues, the two provisions are complementary; they pursue a common objective and are undergirded by the free movement principles in Articles 30 to 34 of the EEC Treaty. Qualifying the competition rules are Articles 36 and 222 of the EEC Treaty, which both address the right of Community law to modify property rights recognized under national law.

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41. *See* Fox, *supra* note 38, at 222-23.

42. Specifically, member states were obligated "to eliminate '[q]uantitative restrictions on imports and all measures having the equivalent effect' . . ., not [to] discriminate on grounds of nationality . . ., [to] report all subsidies they grant and eliminate subsidies that distort competition except as justified by, for example, the need to promote economic development in regions suffering from below normal living standards." *Id.* at 224.

43. *See infra* Section III.B.

44. *See* Eleanor M. Fox, *Monopolization and Dominance in the United States and the European Community: Efficiency, Opportunity and Fairness*, 61 NOTRE DAME L. REV. 981, 985-86 (1986).