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Quality in European Trade Mark Law

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Quality in European Trade Mark Law

Andrew Griffiths



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By Andrew Griffiths*

This article addresses the capacity of trade marks to provide assurance concerning product quality and the importance of this capacity in promoting competition and various forms of innovation. It considers the meaning of “quality” in this context and shows how this can include the aesthetic and intangible characteristics of products as well as their functional and material characteristics. And it is suggested that quality assurance should cover the whole range of variable product characteristics to which at least some consumers attach value. This is because the key economic problem that underlies the need for this assurance is the difficulty that consumers may face in ascertaining or verifying the presence or absence of certain product characteristics. This article explains this problem of information asymmetry and shows how trade marks enable firms to mitigate it by providing quality assurance.

As a matter of law, a trade mark merely guarantees that there is unitary control over the quality of marked products. The force behind a trade mark’s quality assurance is economic in nature and depends on its owner’s interest in maximizing the trade mark’s value as a marketing resource. There are various ways in which the owner can build up this value. These include investing in advertising and other promotional activity and in developing the trade mark’s capacity to confer intangible quality on marked products by establishing an image or particular set of associations for it. This explains the dynamic nature of a trade mark’s capacity to provide quality assurance. The article notes how European trade mark law provides additional protection for some trade marks that focus directly on their value and vulnerability as marketing resources and does not simply rely on protecting the integrity of the underlying legal guarantee.

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I. INTRODUCTION

¶1 Trade marks provide the legal basis of a marketing resource that firms can use to stimulate or strengthen demand for their products and gain a competitive advantage.¹ In particular, firms can use trade marks to provide quality assurance for their products and may have to do this to compete effectively on the basis of product quality. Trade marks enable firms to gain a competitive advantage based on both product quality and quality assurance.

¶2 By registering a sign as a trade mark, a firm acquires the exclusive right to use it to confer a distinctive identity on its products.² This trade mark then provides a reference point for consumers' enquiries and decision-making, and the firm can use it to promote its products through advertising and other marketing activity.³ In the European Union, the Court of Justice (or "CJEU")⁴ has stated that trade marks should help a system of "undistorted competition" to emerge by enabling firms to attract and retain customers by the quality of their products and, in effect, to provide them with quality assurance.⁵ This view of the economic role of trade marks raises a number of issues which this article will explore. These include the significance of product quality as a basis of competition, the importance of quality assurance as a means of achieving undistorted competition, and the way in which trade marks enable firms to provide quality assurance. However, it is first necessary to look more closely at the nature of competition because this provides the context of these issues.

¶3 There are differing conceptions of competition in economics.⁶ In classical economic theory, for example, a perfectly competitive market is one in which a large

¹ This article will focus on the system of registered trade marks in the European Union. However, unregistered signs used as trade marks may also enjoy some legal protection under the national laws of Member States. In the United Kingdom, for example, protection is available under the common law tort of passing off. A registered trade mark must be registered for a designated kind (or kinds) of products on the basis that the applicant is already using the relevant sign as a trade mark for products of this kind or has a *bona fide* intention of doing so.

² "In relation to trade marks . . . [the proprietor] has the exclusive right to use that trade mark for the purpose of putting a product into circulation for the first time . . .": Case 102/77, *Hoffmann-la-Roche v. Centrafarm* 3 E.C.R. 1149, 7 C.M.L.R. 217 (1978).

³ As an activity, marketing covers the various ways in which a firm can shape and influence consumers' preferences and decision-making and respond to these preferences and decisions, with an emphasis on communication and the building of relationships through advertising and other techniques. See Gregory T. Gundlach & William L. Wilkie, *The American Marketing Association's New Definition of Marketing: Perspective and Commentary on the 2007 Revision*, 28 J. PUB. POL'Y & MARKETING 259 (2009); see also Peter F. Drucker, *Marketing and Economic Development*, 22 J. MARKETING 252, 253 (1958); Jenny Darroch, *Drucker on Marketing: An Interview with Peter Drucker*, 37 J. ACAD. MARKETING 8, 10 (2009).

⁴ The Court of Justice is the senior court in the institution which has been officially titled "The Court of Justice of the European Union" since the Treaty of Lisbon took effect on December 1, 2009, and was previously known as "The European Court of Justice". Trade mark law in the European Union has been substantially harmonized and is subject to Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008, which codified First Council Directive 89/104/EEC of 21 December 1988 (as amended) [hereinafter the Directive]. The CJEU has the power to give authoritative rulings on the meaning and application of the Directive's provisions and courts and other tribunals in the Member States must interpret and apply domestic legislation to give effect to the Directive and the rulings of the CJEU on its meaning and application. See Case 106/89, *Marleasing v. La Comercial Internacional*, 1 E.C.R. I-04135 (1992); Case 391/01, 403/01, *Pfeiffer v. Deutsches Rotes Kreuz*, 1 E.C.R. I-08835, 1 C.M.L.R. 1123 (2005).

⁵ See, e.g., Case C-349/95, *Loendersloot (Frits) v. Ballantine* 1998 E.C.R. I-6244 ¶ 22.

⁶ For a detailed survey identifying eleven economic approaches to competition, see ROGER J VAN DEN

number of firms offer homogeneous products to consumers who have a fixed set of preferences and complete information about all matters relevant to their decision-making.⁷ The forces of supply and demand determine the market price, and firms are forced to compete through minimizing their costs. Competition is, in effect, an external disciplinary force that should lead to an equilibrium in which overall wealth is maximized. There would not be any useful role for trade marks in such a market because competing products would not differ and consumers would choose on the basis of price. In reality, however, competing products do differ from each other in various ways of significance to consumers and in particular in terms of quality. This leaves room for firms to compete on the basis of quality and other forms of difference.⁸ Moreover, consumers do not necessarily have complete information about these differences, which means that firms may have to provide quality assurance and compete on this basis as well.⁹ Trade marks, therefore, do have a useful role since they enable firms to inform consumers about product differences and to provide quality assurance and enable consumers to take account of these matters in their decision-making.

¶4

There is another conception of competition that provides guidance on the value of trade marks as a marketing resource. This is the dynamic conception that treats competition as an ongoing process in which firms seek to survive, grow and prosper over time.¹⁰ Here, the focus is on increasing overall wealth in terms of size, quality and diversity.¹¹ Firms can compete to gain an advantage in various ways including product improvement, product development, and engaging in other forms of innovation.¹² The dynamic conception of competition highlights the fact that products and product quality can change in various ways and for various reasons, adding to the potential complexity of consumers' decision-making. Moreover, innovation increases the need for quality assurance as a substitute for information about product quality. Trade marks provide useful reference points for consumers' decision-making and for providing the information and quality assurance that this decision-making may require. It is the need for quality assurance that explains the full economic importance of trade marks in promoting forms of competition based on product quality. Trade marks can be said to "guarantee" product quality by providing credible assurance about the likely quality of the products sold under

BERGH & PETER D. CAMESASCA, EUROPEAN COMPETITION LAW AND ECONOMICS: A COMPARATIVE PERSPECTIVE 54–104 (2006).

⁷ On the characteristics of this ideal and the assumptions on which it rests, see VAN DEN BERGH & CAMESASCA, *supra* note 6, at 19–23.

⁸ LAWRENCE ABBOTT, QUALITY AND COMPETITION: AN ESSAY IN ECONOMIC THEORY (1955).

⁹ George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

¹⁰ See VAN DEN BERGH & CAMESASCA, *supra* note 6, at 86–90. See also MICHAEL H. BEST, THE NEW COMPETITION: INSTITUTIONS OF INDUSTRIAL RESTRUCTURING (1990); James A. Clifton, *Competition and the Evolution of the Capitalist Mode of Production*, CAMBRIDGE J. ECON. 137–51 (1977); Paul Gorecki, *The Process of Competition*, J. ROYAL ECON. SOC. (2000).

¹¹ This is an improvement in terms of "dynamic efficiency", which has been depicted as an increase in the "ecological diversity and complexity of the economy." Richard N. Langlois, *The New Institutional Economics: An Introductory Essay*, in ECONOMICS AS A PROCESS: ESSAYS IN THE NEW INSTITUTIONAL ECONOMICS 15 (Richard N. Langlois ed., 1986).

¹² On the various forms of innovation, see, for example, *European Commission Paper, Innovation Policy: Updating the Union's Approach in the Context of the Lisbon Strategy*, COM (2003) 112 final (Nov. 3, 2003).

them.¹³ They are an “essential element” of a system of undistorted competition because firms have to use them to gain an advantage in the various ways that depend on having this capacity.¹⁴

This article will proceed as follows. Section II will consider the meaning of “quality” in relation to products. Section III will examine the problem of information asymmetry and the need for quality assurance. Section IV will show how a trade mark’s legal guarantee of trade origin underpins a trade mark’s capacity to provide quality assurance. Section V will examine the nature of the quality assurance which a trade mark can provide and the various ways in which the owner of a trade mark can generate and boost this capacity. This section will also note how the law protecting trade marks has come to focus directly on protecting this capacity as well as on protecting it indirectly through protecting the underlying legal guarantee of trade origin. Section VI will draw some conclusions.

For ease of exposition, the following terms will have the following meanings in this article unless the context requires otherwise: “consumers” will refer to all potential purchasers of a firm’s products, including parties further down the stream or streams of production and distribution in which the firm operates; the “Directive” will mean the directive which has substantially harmonized trade mark law in the European Union;¹⁵ the “owner” of a trade mark will mean its registered proprietor and, although it may be a person or a group of persons, the owner will be treated as singular and neuter since it is often a company; “products” will refer to goods and services; and, as in the Directive, the term “undertaking” will be used to refer to a firm or other business enterprise, including a group or network of firms that can function as a cohesive unit.¹⁶ Also, it will be assumed that the owner of a trade mark is the controller of any greater undertaking of which it forms part, though in practice it may be a subordinate member of such an undertaking and have a superior controller.

II. PRODUCT QUALITY

Quality is a notoriously elusive concept,¹⁷ but there are two broad conceptions that are relevant to analyzing the quality of products on the market. One is an absolute standard of excellence, which holds that products should be as good as it is possible for

¹³ The CJEU has referred to the functions of a trade mark as including that of “guaranteeing the quality of the goods or services in question.” See, e.g., *L’Oréal SA v. Bellure NV*, (Case C-487/07) [2009] ETMR at 987, ¶ 58. On the economic nature of this guarantee, see Opinion of Advocate General Jacobs in *Hag II*: “although trade marks do not provide any form of legal guarantee of quality—the absence of which may have led some to underestimate their significance—they do in economic terms provide such a guarantee, which is acted upon daily by consumers.” Case 10/89, *SA Cnl-Sucal v. Hag*, 3 E.C.R. I-03711, 3 C.M.L.R. 571 (1990).

¹⁴ Case C-349/95, *Loendersloot (Frits) v. Ballantine* 1998 E.C.R. I-6244 ¶ 22. On how competition through quality and competition through innovation may conflict with each other, see Robert E. Cole & Tsuyoshi Matsumiya, *Too Much of a Good Thing? Quality as an Impediment to Innovation*, 50 CAL. MGMT. REV. 77 (2007).

¹⁵ See *supra* note 4 and accompanying text.

¹⁶ Case 9/93, *IHT v. Ideal-Standard*, 3 E.C.R. I-02789, 3 C.M.L.R. at 857, ¶¶ 38–39 (1994).

¹⁷ Carol A. Reeves & David A. Rednar, *Defining Quality: Alternatives and Implications*, 19 ACAD. MGMT. REV. 419 (1994). See generally ROBERT M. PIRSIG, *ZEN AND THE ART OF MOTORCYCLE MAINTENANCE: AN INQUIRY INTO VALUES* (1974).

them to be.¹⁸ This ideal is hard to define except in vague and abstract terms and, whilst achieving this standard is a worthy objective, it has become less relevant in the age of the mass production and mass marketing of standardized products compared to ensuring that they are consistent, reliable and free from defects.¹⁹ For many products, achieving excellence is likely to be costly and something that many consumers are willing to forego in exchange for a lower price.

¶8 The other broad conception of quality is a relative and variable standard covering a range of characteristics which consumers look for in a product, but which they are willing to trade off against price in search of an optimal balance or overall “value.”²⁰ This balance may vary with the kind of products at issue, with the preferences of particular consumers, and also across time.²¹ Consumers will attach importance not only to the level of the quality of a particular product, but also to whether they can be confident that it does have the level that it purports to have.²² From this perspective, product quality has positive and negative aspects: products should match the specifications they are presented as having and meet the requirements of consumers and they should be free from defects and any other potential causes of consumer dissatisfaction.²³ Confidence about both of these aspects of quality is necessary for consumers to be able to choose among competing products by looking for the best overall value. Trade marks are a means of providing the kind of information and assurance on which this confidence can be based.

¶9 In the economic analysis of trade mark law, products of the same kind have been presented as liable to vary on the basis of “quality” and “variety” characteristics.²⁴ In this categorization, quality characteristics are defined as ones which all consumers are likely to regard as improving and adding value to a particular product, such as its functional performance, reliability, and durability. Variety characteristics are defined as ones that only some consumers are likely to value according to their subjective preferences and tastes.²⁵ However, it is arguable that the capacity to provide quality assurance can be important in relation to both kinds of characteristic and that quality should therefore be treated as covering all variable characteristics to which consumers may attach value. Moreover, consumers may differ significantly in their valuation of so-called “quality” characteristics, and differentiation has become an increasing source of value for many kinds of products. The latter trend reflects changes in the second half of the twentieth century on both the supply side, with smaller scale and more flexible systems of production becoming as efficient as mass production,²⁶ and the demand side, with consumers attaching greater weight to product differences in their decision-making.²⁷

¹⁸ B.W. Tuchman, *The Decline of Quality*, N.Y. TIMES MAG., Nov. 2, 1980, at 38–41.

¹⁹ David A. Garvin, *What Does “Product Quality” Really Mean?*, 26 SLOAN MGMT. REV. 25 (1984); Reeves & Rednar, *supra* note 17.

²⁰ See Reeves & Rednar, *supra* note 17, at 420–21.

²¹ Art Kleiner, *Beware Product Death Cycles*, STRATEGY AND BUSINESS, <http://www.strategy-business.com/article/enews042805?gko=86f20> (last visited Sept. 17, 2012).

²² See Garvin, *supra* note 19; David A. Garvin, *Product Quality: An Important Strategic Weapon*, BUS. HORIZONS, at 40–43 (1984).

²³ JURAN’S QUALITY CONTROL HANDBOOK § 2.3 (J.M. Juran & Frank M. Gryna eds., 1988); see also Reeves & Rednar, *supra* note 17, at 424–25.

²⁴ Nicholas S. Economides, *The Economics of Trademarks*, 78 TRADEMARK REP. 523, 525 (1988).

²⁵ *Id.*

²⁶ RICHARD N. LANGLOIS, *THE DYNAMICS OF INDUSTRIAL CAPITALISM: SCHUMPETER, CHANDLER, AND THE NEW ECONOMY* (2007); MICHAEL J. PIORE & CHARLES F. SABEL, *THE SECOND INDUSTRIAL DIVIDE:*

¶10 In the literature on quality management,²⁸ one analyst has identified eight “dimensions” of product quality in an attempt to provide more detailed guidance on the nature of quality and how an undertaking can produce and reproduce it.²⁹ Six of these dimensions identify various functional and material characteristics to which consumers are likely to attach value when choosing among competing products and which provide some elaboration of the broad positive and negative aspects of quality that were noted above. They are performance, features (or “bells and whistles”), reliability, conformance with specifications, durability and serviceability (the speed and ease with which a product can be repaired if necessary).³⁰ However, the other two dimensions, namely aesthetics and perceived quality, go beyond the functional and material quality of products and are of particular relevance to analyzing the role of trade marks in relation to product quality. And the reference to “perceived quality” highlights the close connection that can exist in practice between product quality and quality assurance and the fact that consumers may come to base their decisions on quality assurance rather than on actual product quality.

¶11 The aesthetic quality of a product covers the various ways in which it may appeal to the senses of consumers including its appearance, design, and presentation. Marketing practitioners have emphasized the importance of aesthetics, recognizing that this can influence consumers’ decision-making in various ways, and in some cases, help to shape their initial impressions of functional and material quality.³¹ Moreover, while aesthetics are often a matter of personal judgment, for some products (such as designer clothing and fashion goods), consumers may seek guidance from others whom they regard as better qualified and, therefore, attach value to quality assurance.³² Aesthetic quality can also be linked to the increasing value that consumers attach to product differentiation, and to the fact that this differentiation can be designed to appeal to consumers at the emotional or psychological level.³³ In effect, marketing can be used to give products an intangible layer of quality. An undertaking may therefore use advertising and other marketing

POSSIBILITIES FOR PROSPERITY (1984).

²⁷ This trend can be related to the idea that consumer demand tends to evolve up a scale of human needs from a preoccupation with satisfying lower-order “deficit” needs (such as physiological needs, safety and security) to much greater interest in fulfilling higher-order needs or wants (such as status and self-fulfilment), which has been drawn from the humanistic psychology of Abraham Maslow. DAVID A. AAKER & ERICH JOACHIMSTHALER, *BRAND LEADERSHIP* 48–49 (2000); J.B. Swann et al., *Trademarks and Marketing*, 91 TRADEMARK REP. 787 (2001). The trend can also be related to Thorstein Veblen’s theory of conspicuous consumption and the idea of consumption as a means of signalling social status. Barton Beebe, *The Semiotic Analysis of Trademark Law*, 51 UCLA L. REV. 621 (2004); R. Joseph Monsen & Anthony Downs, *Public Goods and Private Status*, 23 PUB. INTEREST 64, 64–77 (1971).

²⁸ See *supra* note 17.

²⁹ See GARVIN, *supra* note 19; GARVIN, *supra* note 22; David A. Garvin, *Competing on the Eight Dimensions of Quality*, 65 HARV. BUS. REV. 101, 101–09 (1987) (arguing that an undertaking should focus its efforts on certain of these dimensions in particular and look to find a suitable “niche” in order to achieve a competitive advantage).

³⁰ *Id.*

³¹ See John J. Wheatley & John S. Y. Chiu, *The Effects of Price, Store Image, and Product and Respondent Characteristics on Perceptions of Quality*, 14 J. MARKETING RES. 181 (1977). The work of Louis Cheskin has been influential in this respect. See, e.g., LOUIS CHESKIN, *COLORS: WHAT THEY CAN DO FOR YOU* (1947); see also LOUIS CHESKIN, *HOW TO PREDICT WHAT PEOPLE WILL BUY* (1957).

³² Brian Hilton et al., *The Ethics of Counterfeiting in the Fashion Industry: Quality, Credence and Profits Issues*, 55 J. BUS. ETHICS 345 (2004).

³³ See AAKER & JOACHIMSTHALER, *supra* note 27; see also NANCY F. KOEHN, *BRAND NEW: HOW ENTREPRENEURS EARNED CONSUMERS’ TRUST FROM WEDGWOOD TO DELL* 307–39 (2001).

techniques to associate its products with an attractive image or a specific set of values to increase its appeal to consumers.³⁴ Consumers may then attach greater value to these products because they offer a means of self-expression, a sense of belonging to a community, or a way of making a statement about social status.³⁵ This at least partly explains the high prices that some consumers may be willing to pay for luxury goods and other “status” products.

¶12 Trade marks can play a crucial role in creating and maintaining intangible quality because they provide the means whereby undertakings can cultivate an image and other associations for their products in advertising and other promotional activity. This role goes beyond providing reassurance about the quality of the marked products, to a more active role of conferring intangible quality onto the products or even forming part of their overall quality. The capacity of trade marks to confer intangible quality is a controversial aspect of trade mark law because it may require a wider zone of legal protection than is necessary to protect trade marks’ capacity to provide assurance about other forms of quality.³⁶ This point will be considered in later sections of this article where it will be suggested that the two roles cannot be neatly separated because intangible quality can also be a source of assurance about “tangible” quality. One reason why this aspect of trade mark law has been so controversial is that it is debatable whether intangible quality has enough social value to be worth protecting, and it is even arguable that enabling undertakings to engage in this form of marketing is a cause of social harm.³⁷ In any event, it adds complexity to competition in the other dimensions of quality through creating additional emotional and psychological “switching costs” for consumers.³⁸ Nevertheless, in the case of European trademark law, the CJEU has ruled that the overall quality of luxury goods can include certain intangible or “mental” characteristics which result from their being associated with a prestigious image which bestows on them an aura of luxury, and that this particular quality-conferring role of a trademark can justify specific legal protection.³⁹

³⁴ For a brief summary of how “Values, Attitudes and Lifestyles” or “VALs” marketing has been used to influence consumer decision-making in the United Kingdom since the 1950s, see ED HOWKER & SHIV MALIK, *JILTED GENERATION: HOW BRITAIN HAS BANKRUPTED ITS YOUTH* 164–72 (2010); see also Wolfgang Streeck, *Citizens as Consumers: Considerations on the New Politics of Consumption*, 76 *NEW LEFT REV.* 27, 28–36 (2012).

³⁵ GARY S. BECKER & KEVIN M. MURPHY, *SOCIAL ECONOMICS: MARKET BEHAVIOR IN A SOCIAL ENVIRONMENT* 84–104 (2000); see also Barton Beebe, *Intellectual Property Law and the Sumptuary Code*, 123 *HARV. L. REV.* 809 (2010); Douglas B. Holt, *What Becomes an Icon Most?*, 81 *HARV. BUS. REV.* 43 (2003).

³⁶ See, e.g., Dev Gangjee & Robert Burrell, *Because You’re Worth It: L’Oréal and the Prohibition on Free Riding*, 73 *MODERN L. REV.* 282 (2010); Martin Senftleben, *Trade Mark Protection: A Black Hole in the Intellectual Property Galaxy*, 42 *INT’L REV. INTELL. PROP. & COMPETITION L.* 383–87 (2011).

³⁷ See, e.g., Ralph S. Brown, Jr., *Advertising and the Public Interest: Legal Protection of Trade Symbols*, 57 *YALE L.J.* 1165, 1169 (1948); see also Avner Offer, *The Mask of Intimacy: Advertising and the Quality of Life*, in *THE CHALLENGE OF AFFLUENCE: SELF-CONTROL AND WELL-BEING IN THE UNITED STATES AND BRITAIN SINCE 1950*, at 103 (2006).

³⁸ On the impact of “switching costs” on competition, see Paul Klempner, *Markets with Consumer Switching Costs*, 102 *Q. J. ECON.* 375 (1987); Paul Klempner, *Competition when Consumers Have Switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade*, 62 *REV. ECON. STUD.* 515 (1995).

³⁹ *Copad v. Christian Dior Couture* (Case C-59/08) [2009] *ETMR* 683 ¶¶ 24–26; *Parfums Christian Dior v. Evora* (Case C-337/95) [1997] *ETMR* 26, at 45.

¶13 As indicated above, it is arguable that the eighth dimension of “perceived quality” is better viewed as an aspect of quality assurance, and therefore as an additional basis on which undertakings may have to compete with each other. The problem of information asymmetry, which will be examined in section III, is that consumers may have to base their choices and decision-making on the perceived quality of a product rather than its actual quality. Consumers may look to the appearance of a product and even to its price to help form an initial perception of its likely quality,⁴⁰ but need more credible forms of quality assurance for reliable guidance.⁴¹ Perceived quality can be based on the fact that marked products or a particular trade mark enjoys a reputation in the minds of consumers concerning product quality. It can also reflect certain other signals that give them reassurance that the actual quality of marked products will meet their expectations. Consumers may therefore focus on perceived quality in their decision-making. The economic problems that explain the need for quality assurance and the importance of perceived quality will be examined in more detail.

III. INFORMATION ASYMMETRY AND THE NEED FOR QUALITY ASSURANCE

¶14 For undertakings to be able to compete with each other in terms of the quality of their products, consumers should be able to recognize differences in quality and to specify fully and precisely their requirements (both positive and negative) in this respect. In practice, this may be especially difficult in relation to the negative aspect of quality, since consumers would have to anticipate all potential causes of dissatisfaction at the time of purchase. This problem increases the costs of communication, which include the risks of disappointment due to errors and other forms of miscommunication. One advantage that trade marks have as a means of combating this problem is that they identify and refer to products that are likely to be consistent with each other. This can be a much less costly basis for communication and decision-making, especially in the case of recurring purchases.

¶15 A related problem is that the quality of a particular undertaking’s products may depend on its attributes as an organization, these covering such matters as effective teamwork and the kind of idiosyncratic practices, skills and knowledge that have been termed organizational “capabilities.”⁴² It may be impossible to specify the resulting quality objectively as a particular combination of positive and negative characteristics, or even as the outcome of a specific set of procedures, especially since it may not be possible to replicate the necessary capabilities.⁴³ Again, a trade mark has value as a basis for

⁴⁰ See Wheatley & Chiu, *supra* note 31.

⁴¹ See, e.g., Jacob Jacoby et al., *Price, Brand Name and Product Composition Characteristics as Determinants of Perceived Quality*, 55 J. APPLIED PSYCHOL. 570, 570 (1971) (“[N]either price nor brand name had significant effects on perceived quality except when product composition characteristics were allowed to vary between product samples.”).

⁴² See, e.g., Richard N. Langlois, *Modularity in Technology and Organization*, 49 J. ECON. BEHAV. & ORG. 19 (2002); Richard N. Langlois & Nicholas J. Foss, *Capabilities and Governance: The Rebirth of Production in the Theory of Economic Organization*, 52 KYKLOS 201 (1999). See generally EDITH PENROSE, *THE THEORY OF THE GROWTH OF THE FIRM* (4th ed. 2009); G.B. Richardson, *The Organisation of Industry*, 82 ECON. J. 883 (1972), reprinted in G.B. RICHARDSON, *THE ECONOMICS OF IMPERFECT KNOWLEDGE: COLLECTED PAPERS OF G.B. RICHARDSON* 143 (1998).

⁴³ For a discussion on the unique character of the products of tacit knowledge and skills acquired through experience see MICHAEL POLANYI, *PERSONAL KNOWLEDGE: TOWARDS A POST-CRITICAL*

communication because it identifies products that are likely to be consistent with each other at the deep level that can be achieved through their being the products of the same undertaking. This is an important factor as to why an undertaking can gain a competitive advantage on the basis of product quality, and why the trade mark system is necessary to secure this advantage.

¶16 However, the main explanation for the importance of trademarks in competition based on product quality lies beyond these problems of communication in the economic problem known as “information asymmetry.”⁴⁴ This means that consumers may not be able to discern and verify the quality of a particular product and therefore may not distinguish high quality products from lower quality competitors, or at least may face substantial costs in order to do so. It is attributable both to a lack of expertise on the part of consumers and to the fact that it may simply not be possible to discern all the positive and negative characteristics of a product that contribute to its overall quality at the time of purchase. The nature and extent of the problem varies according to the kind of product and the kind of expertise that may be necessary to determine a particular consumer’s requirements and to detect or verify the presence or absence of particular characteristics.⁴⁵ The problem increases as products become more complex and where systems of packaging and distribution make it harder to inspect products prior to purchase. For all these reasons, competition based on product quality has come to depend on the ability of undertakings to provide credible quality assurance to consumers.

¶17 In terms of its impact on the overall wealth of society, information asymmetry, if not mitigated, would give rise to significant static and dynamic costs.⁴⁶ The static costs include the additional “search costs” which consumers would have to incur in order to verify the quality of a product, including any remaining risk of purchasing an inferior product. Search costs increase the total price that consumers, in effect, have to pay for a product and therefore distort competition. If not mitigated, they represent a significant barrier for consumers wishing to purchase a product on the basis of quality. The dynamic costs reflect the fact that, if not combated, information asymmetry would reduce or undermine the incentives that firms have to produce and supply good quality products which are free from deficiencies. It would also give rise to harmful incentives by favoring unscrupulous firms selling inferior products. Moreover, it would discourage various forms of innovation that could improve product quality or reduce production costs, and especially innovations that would make product quality harder to verify.

¶18 In the economic analysis of information, the characteristics of products that contribute to their overall quality (including freedom from deficiencies) have been categorized as “search” or “experience” according to whether or not their presence or absence can (in theory at least) be discerned or verified at the point of purchase, or at

PHILOSOPHY 49–65 (corrected ed. 1962).

⁴⁴ Akerlof, *supra* note 9; A. Postlethwaite, *Asymmetric Information*, in THE NEW PALGRAVE: ALLOCATION, INFORMATION AND MARKETS 35 (John Eatwell et al. eds., 1989); C. Wilson, *Adverse Selection*, in THE NEW PALGRAVE: ALLOCATION, INFORMATION AND MARKETS (John Eatwell et al. eds., 1989).

⁴⁵ Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67 (1973).

⁴⁶ See William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265 (1987).

least prior to use or consumption.⁴⁷ In this scheme, services are by their nature “experience” products, which is why purchasing services can be particularly problematic.⁴⁸ Moreover, some product characteristics may not be verifiable or become apparent until long after purchase and the consumers of some products may have to rely on the expertise of the service provider for guidance on the level of quality that is appropriate for their particular requirements.⁴⁹ For this reason, a further category of “credence characteristics” is used to refer to characteristics that consumers have to take on trust from producers or suppliers.⁵⁰ Products can be categorized as “search,” “experience” and “credence” according to the type of characteristic likely to dominate consumers’ decision-making.⁵¹

¶19 Undertakings wishing to compete on the basis of the quality of their products, therefore, have to find some way of combating the problem of information asymmetry and reducing consumers’ search costs. Otherwise, they would face difficulty in selling their products at a sufficiently high price to secure an adequate return for the additional costs that producing or supplying quality products is likely to involve.⁵² In effect, an undertaking has to find a way of enabling consumers to acquire the necessary information at a relatively low cost or provide a satisfactory substitute for this information. The law can help to mitigate the problem of information asymmetry at a general level, in particular by setting and enforcing minimum standards of quality and requiring the disclosure of information about quality. Beyond this, undertakings have to provide credible assurance about the quality of their products and they can use trade marks to do this.

¶20 The above categorization of products and product characteristics according to the nature and extent of the difficulty that consumers may face in order to verify their presence (or absence) is also relevant to the nature of the quality assurance that an undertaking may have to provide in this respect and to the extent of the investment that this may require. The difficulty of providing satisfactory assurance about experience and credence characteristics helps to explain the extent of the competitive advantage that an undertaking may achieve if it can do so and the premium prices that it may be able to charge as a result. Section IV will therefore examine the legal basis of a trade mark’s capacity to provide quality assurance that may cover all forms of product characteristics.

IV. A TRADE MARK’S LEGAL GUARANTEE OF QUALITY CONTROL

¶21 The portrayal of a trade mark as “guaranteeing” product quality is potentially misleading because the trade mark does not of itself give consumers any directly enforceable legal rights concerning the actual quality of marked products, and its owner’s incentive to meet consumers’ expectations in terms of quality does not result from any corresponding threat of legal sanction.⁵³ Instead, the incentive results from the owner’s

⁴⁷ Phillip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311 (1970).

⁴⁸ See Reeves & Rednar, *supra* note 17, at 426–27.

⁴⁹ Darby & Karni, *supra* note 45.

⁵⁰ *Id.*

⁵¹ Economides, *supra* note 24.

⁵² See Akerlof, *supra* note 9.

⁵³ F.K. Beier, *Territoriality of Trade Mark Law and International Trade*, 1 INT’L REV. INDUS. PROP. & COPYRIGHT L. 48, 64 (1970); see also *Hag II*, 3 C.M.L.R. 571, at 583 (1990) (opinion of AG Jacobs). The owner of a trademark is obliged to comply with any independent legal obligation to which it is subject concerning the quality of a marked product, the provision of information relating to quality and the risk of

interest in building and maintaining a good reputation for its trade mark and in not risking damage to or the loss of such a reputation. This incentive does rest on a legal guarantee, but it is a guarantee that one particular undertaking has authorized the marketing of the marked products under the trade mark and that this undertaking is in a position to control their quality.⁵⁴ In trade mark law, a trade mark's signification of this exclusive right is also presented as a legal guarantee about the "origin" (or "trade origin") of the marked products.⁵⁵

¶22 A trade mark owner's exclusive right to authorize the use of the trade mark to market products and therefore to authorize products of the relevant kind as legitimate marked products is the legal basis of the trade mark's so-called "guarantee" of quality.⁵⁶ This exclusivity means that the owner is entitled to prohibit third parties from using its trademark to identify or refer to any products of the relevant kind which it has not authorized as marked products even if it is arguable that the unauthorized products are of the same quality as legitimate marked products and even if they have been produced or supplied by the same firm and according to the same specifications.⁵⁷ In other words, the trade mark signifies unitary control over quality rather than a particular standard of quality.⁵⁸ The owner has exclusive control over the track record of the marked products, along with the exclusive right to benefit from any power to attract consumers, which the trade mark may acquire on the basis of this track record. The owner therefore has a good reason not to authorize products as marked products unless it has a reliable basis on which it can verify and vouch for their quality.

¶23 The CJEU has gone further and established that the ability of a trade mark owner (or the superior controller of a greater undertaking) to exercise continuing control over

misleading consumers on matters of quality. In particular, a trade mark should not deceive consumers about the quality of marked products, and the Directive provides that a trade mark should be refused registration or, as appropriate, be liable to revocation if it is or becomes "of such a nature as to deceive the public, for instance as to the nature, quality or geographical origin of the goods or service." The Directive, *supra* note 4, arts. 3.1(g), 12.2(b); *see also* Elmer William Hanak, III, *The Quality Assurance Function of Trademarks*, 43 *FORDHAM L. REV.* 363 (1974).

⁵⁴ Case 9/93, *IHT Internazionale Heiztechnik GmbH v. Ideal Standard GmbH*, 3 C.M.L.R. 857, ¶¶ 38–39 (1994).

⁵⁵ Recital (11) of the preamble to the Directive states that the function of the protection of a trade mark is "in particular to guarantee the trade mark as an indication of origin . . ." The Directive, *supra* note 4, preamb. recital 11. The CJEU has described the "essential" function of a trademark as being "to guarantee the identity of the origin of the trade-marked product to the consumer or ultimate user." Case 102/77, *Hoffmann-La Roche & Co. AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH*, 3 C.M.L.R. 217, ¶ 7 (1978); *Hag II*, 3 C.M.L.R. 571, ¶ 14. The use of the term "origin" in this context has been criticized because of its potential ambiguity. *See, e.g.*, WILLIAM CORNISH, *INTELLECTUAL PROPERTY: OMNIPRESENT, DISTRACTING, IRRELEVANT?* 89–90 (2004); FRANK I. SCHECHTER, *THE HISTORICAL FOUNDATIONS OF THE LAW RELATING TO TRADE-MARKS* 147–49 (Faculty of Law of Columbia Univ. et al. eds., Columbia University Press 1999) (1925). Nevertheless, the use of this term has continued. This article will use the variant "trade origin" to emphasize the special meaning of the term in trade mark law unless the context requires otherwise.

⁵⁶ *See supra* notes 13–16 and accompanying text.

⁵⁷ *Major Bros. v. Franklin & Son*, [1908] 1 K.B.KB 712 (H.C.); *Primark v. Lollypop Clothing*, [2001] ETMR 334 (H.C.).

⁵⁸ *See, e.g.*, Lord Wright's explanation of a trademark's guarantee of trade origin in *Aristoc v. Rysta*: "The word 'origin' is no doubt used in a special and almost technical sense in this connection, but it denotes at least that the goods are issued as vendible goods under the *aegis* of the proprietor of the trade mark, who thus assumes responsibility for them . . ." [1945] A.C. 68 at 101–02.

product quality is a distinct element of a trade mark's legal guarantee to consumers.⁵⁹ It was necessary to isolate this element in order to determine whether the respective products of two firms that are marketed under the same trade mark in different territories of the European Union should be treated as having the same trade origin.⁶⁰ The CJEU has ruled that there must be a tie of legal or economic dependence between the two firms. In other words, the owner of a trade mark and any other firm purporting to authorize products as marked products should be linked in a way that establishes or reflects a single point of continuing control over the quality of the products in question for them to have the trade origin that the trade mark signifies.⁶¹

¶24 Moreover, trade mark law does not limit the mechanisms through which the necessary unitary control over quality can be exercised.⁶² In the case of marked goods, for example, the owner is free to select or commission the goods from other firms because it can control their quality through inspection or by seeking reassurance before endorsing them as marked goods.⁶³ In the case of goods or services, the owner is free to delegate the right to authorize products as marked products to another firm under a licence because it can control their quality by enforcement of the terms of the licence.⁶⁴ Article 8 of the Directive reinforces a trade mark owner's ability to control quality through a licence by providing that a licensee's power to authorize products as marked products is negated if there is a breach of any term relating to "the quality of the goods manufactured or of the services provided by the licensee."⁶⁵

¶25 A trade mark's signification of continuing control over product quality is reinforced by certain ancillary rights that its owner enjoys over its use as a product identifier and as a reference point in advertising and promotional material. These include the owner's

⁵⁹ "[A trade mark] must constitute a guarantee that all the products bearing it have been manufactured under the supervision of a single enterprise to which responsibility for their quality may be attributed." *Hag II*, 3 C.M.L.R. 571, ¶ 13; see also *IHT v. Ideal-Standard*, 3 C.M.L.R. 857, ¶¶ 38–39.

⁶⁰ See, e.g., the scenarios in *Hag II*, 3 C.M.L.R. 571 and *IHT v. Ideal-Standard*, 3 C.M.L.R. 857. Under the principle of the free movement of goods, which is now set out in Article 34 of the Treaty on the Functioning of the European Union (or "TFEU"), the owner of a trade mark cannot prohibit its use for the further marketing of goods which another firm has already marketed under the same trade mark elsewhere in the European Union if the other firm's goods have the same trade origin and in effect forms part of the same undertaking. Consolidated Version of the Treaty on the Functioning of the European Union art. 34, Mar. 30, 2010, 2010 O.J. (C 83) 47 [hereinafter TFEU].

⁶¹ *Hag II*, 3 C.M.L.R. 571, ¶ 15; *IHT v. Ideal-Standard*, 3 C.M.L.R. 857, ¶¶ 37–43. It is not necessary that the unitary control over product quality be exercised vigilantly as long as there is a basis through which it can be exercised. *IHT v. Ideal-Standard*, 3 C.M.L.R. 857, ¶¶ 38–39. On *de facto* economic control, see *Doncaster Pharm. Grp. v. Bolton Pharm.* 100, [2006] EWCA (Civ) 661.

⁶² "The origin which the trade mark is intended to guarantee . . . is not defined by reference to the manufacturer but by reference to the point of control of manufacture." *IHT v. Ideal-Standard*, 3 C.M.L.R. 857, ¶ 37.

⁶³ See, e.g., *Primark v. Lollypop*, [2001] ETMR 334 (H.C.).

⁶⁴ *IHT v. Ideal-Standard*, 3 C.M.L.R. 857, ¶ 37.

⁶⁵ Article 8.2 of the Directive provides:

The proprietor of a trade mark may invoke the rights conferred by that trade mark against a licensee who contravenes any provision in his licensing contract with regard to: (a) its duration; (b) the form covered by the registration in which the trade mark may be used; (c) the scope of the goods or services for which the licence is granted; (d) the territory in which the trade mark may be affixed; or (e) the quality of the goods manufactured or of the services provided by the licensee.

The Directive, *supra* note 4, art. 8.2. See *Copad v. Christian Dior* (Case C-59/08) [2009] ETMR 683 ¶¶ 22–23.

right to prohibit the use of its trade mark to identify a licensee's products if there has been breach of a term relating to product quality. In this context, the CJEU has ruled that the quality of a product can include intangible quality and has therefore been willing to protect the capacity of certain trade marks to confer this kind of quality on marked products. This means that the owner may be entitled to prohibit use of its trade mark after breach of a term that contributes to the cultivation or protection of a particular image or set of associations for the trade mark. Such a term could include a prohibition on distribution outside an authorized network or a restriction on certain forms of advertising.⁶⁶ However, the CJEU has also ruled that the impact of infringing such a term on the trade mark's capacity to confer intangible quality is different from the impact of infringing a term relating to tangible quality on the trade mark's capacity to provide quality assurance and that assessing the legal consequences of a particular breach should take account of this difference.⁶⁷

¶26 In the case of marked goods, the owner is also entitled to prohibit the use of its trade mark as a product identifier for further marketing in circumstances in which the owner's ability to vouch for their quality may be threatened. This gives the owner the ability to exercise some continuing control over product quality as marked goods move downstream. As a general rule, the owner of a trade mark cannot prohibit its use as a product identifier for further marketing within the European Economic Area (or "EEA").⁶⁸ This "exhaustion" of the owner's rights ensures that the owner can profit from the marketing power of its trade mark for the first marketing of goods, but it cannot secure any additional profit on the further marketing of the goods within the EEA.⁶⁹ This is designed to encourage downstream or "intra-brand" competition for marked goods and gives effect to the fundamental principle of the free movement of goods,⁷⁰ which is designed to combat territorial partitioning and price discrimination within the EEA. However, the Directive provides that the owner's rights should not be exhausted if it has "legitimate reasons" to oppose use of its trade mark, "especially where the condition of the goods is changed or impaired after they have been put on the market."⁷¹ The CJEU has ruled that the owner has a *prima facie* right to prohibit the use of its trade mark after any unauthorized interference with the marked goods in question that occurs after first marketing, including repackaging and even re-labelling.⁷²

⁶⁶ Copad v. Christian Dior Couture (Case C-59/08) [2009] ETMR 683 ¶¶ 22–24, 27–37.

⁶⁷ *Id.* ¶¶ 30–32. See Advocate General Kokott's discussion of this point in her Opinion to the CJEU, *id.* ¶¶ AG30–AG37.

⁶⁸ The Directive, *supra* note 4, art. 7. This provision applies if either the owner or an economically-linked undertaking has marketed the goods in question under the trade mark anywhere in the EEA or has consented to their being marketed under the trade mark in the EEA. The EEA includes the member states of the European Union and certain member states of the European Free Trade Association.

⁶⁹ See Viking Gas v. Kosan Gas (C-46/10) [2011] ETMR 58 ¶¶ 31–32.

⁷⁰ Article 34 of the Treaty on the Functioning of the European Union (or "TFEU") prohibits any legal restrictions on the movement of goods between member states for further marketing unless the restrictions can be justified on grounds of the protection of "industrial and commercial property." TFEU, *supra* note 60, arts. 34, 36.

⁷¹ The Directive, *supra* note 4, art. 7. The CJEU has ruled that the circumstances in which this is the case are not limited to activity that may affect the functional or material quality of the marked products. *Viking Gas v. Kosan Gas* (C-46/10) [2011] ETMR 58 ¶ 36.

⁷² Case C-102/77, Hoffmann-La Roche & Co. AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 3 C.M.L.R. 217 (1978); Bristol-Myers Squibb v. Paranova (C-427/93) [1996] ETMR 1; Boehringer Ingelheim (No. 2) (C-348/04) [2007] ETMR 1164; Wellcome v. Paranova (C-276/05) [2009]

¶27 However, an unqualified right to prohibit the use of a trade mark after any unauthorized interference with the marked goods could undermine the principle of the free movement of goods, since many kinds of goods cannot easily be sold in exactly the same form in a different territory, at least not without losing much of the marketing advantage that the trade mark provided at first marketing.⁷³ The same potential problem exists in relation to the trade mark owner's exclusive right to authorize the use of its trade mark for the first marketing of goods if the owner (or a greater undertaking of which the owner forms a part) uses different trade marks to market what are essentially the same products in different member states of the EEA.⁷⁴ Without qualification, the owner could prohibit the further marketing of rebranded goods that might be necessary to ensure effective downstream competition within the EEA.

¶28 Therefore, to give full effect to the principle of the free movement of goods, the CJEU has established that a third party such as a parallel importer should be entitled to use a trade mark for the further marketing of goods in the EEA even after unauthorized interference with marked goods or, as the case may be, rebranding as long as the third party can satisfy five conditions.⁷⁵ These conditions are equivalent to the broad terms that the owner would be likely to impose on a licensee in order to protect the trade mark's value as a signifier of exclusive control over product quality and its reliability as a basis for providing quality assurance.⁷⁶ In particular, a third party wishing to use the trade mark in such circumstances must give prior notice in writing to the owner along with a sample of the goods in its new packaging (or as otherwise adapted); it must prove that the unauthorized interference cannot have affected the original condition of the goods inside the packaging (whether directly or indirectly) and that the presentation of the adapted goods for further marketing (including the quality and appearance of their packaging) cannot damage the reputation of the trade mark and its owner.⁷⁷ These conditions therefore help to protect the economic value of a trade mark as a signifier of exclusive control over product quality despite the threat to this exclusive control from the "free movement" rights that parallel importers and other third parties enjoy.⁷⁸

ETMR 363.

⁷³ Article 36 of the TFEU provides that the protection of property rights should not constitute a "means of arbitrary discrimination or a disguised restriction" on trade between member states and that any derogation from the principle of free movement must be limited accordingly. TFEU, *supra* note 60, art. 36.

⁷⁴ *Pharmacia & Upjohn v. Paranova* (C-379/97) [1999] ETMR 937.

⁷⁵ Case C-102/77, *Hoffmann-la Roche v. Centrafarm*, 3 C.M.L.R. 217 (1978); Case C-427/93, *Bristol-Myers Squibb v. Paranova* [1996] ETMR 1; *Pharmacia & Upjohn v. Paranova* (C-379/97) [1999] ETMR 937; *Boehringer Ingelheim v. Swingward* (No. 1) (Case C-143/00) [2002] ETMR 898; *Boehringer Ingelheim* (No. 2) [2007] ETMR 1164; *Wellcome v. Paranova* (Case C-276/05) [2009] ETMR 363; *Viking Gas v. Kosan Gas* (C-46/10) [2011] ETMR 1117; *Orifarm v. Merck* (C-400/09 & C-207/10) [2011] ETMR 1142.

⁷⁶ *Hoffmann-la Roche*, 3 CMLR 217 ¶ 11; *Orifarm*, [2011] ETMR 1142 ¶ 26.

⁷⁷ *Bristol-Myers Squibb* [1996] ETMR 1 ¶ 79. An indirect effect on their condition includes, for example, the omission of important information or the insertion of extra articles that are not suitable.

⁷⁸ The CJEU has also ruled that a third party which is entitled to use a trade mark for the further marketing of marked goods has an ancillary right to use it in advertising or other promotional activity to publicize the further marketing, but that this ancillary right is subject to the owner's interest in protecting the trade mark's reputation including any image or aura it has acquired. *Parfums Christian Dior v. Evora* (Case C-337/95) [1998] ETMR 26 ¶¶ 39–48. The CJEU said that a balance had to be struck between the owner's interest in protecting the image and "the reseller's legitimate interest in being able to resell the goods in question by using advertising methods which are customary in his sector of trade." *See supra* note 39.

¶29 A trade mark therefore guarantees that one undertaking (and, in effect, one organizational governance structure) has control over the quality of marked products and that this undertaking has consented to these particular products being marketed with this identity. It signifies an assumption of commercial responsibility for product quality in the sense that the undertaking is willing for these products to contribute to the track record of the marked products and benefit from any attractive power that the trade mark confers. However, this legal guarantee does not of itself provide any assurance about the quality of marked products. Instead, the assurance depends on the degree to which the undertaking exercises its control over quality in practice.

¶30 The CJEU has elaborated a trade mark's legal guarantee of trade origin in a way that enables a trade mark to send an ancillary legal message about the organizational context of the product identity which it signifies. A trade mark can be used to signify that there is an organizational or economic link between its product identity and another identity which is used to market products of the same, similar, or even dissimilar kind. The trade mark may do this through including a particular name or other sign in its component features that it shares in common with another trade mark or it may do so through some other kind of similarity to another trade mark. Also, where an undertaking uses more than one trade mark to establish a particular marketing identity, it may use one (or more) of these trade marks to signify an organizational link or to signify a broader identity such as a corporate or umbrella brand.

¶31 Using a trade mark to signify an organizational link does not send out the same clear message in terms of product quality consistency as the trade mark's guarantee that marked products have a common trade origin, but the signal may still provide some guidance and assurance about likely product quality. The ability to signify an organizational link in this way not only increases the potential value of the trade mark as a marketing resource, but also increases its vulnerability to damage from signs that consumers may perceive as signifying a link where none in fact exists. The CJEU has therefore ensured that the legal protection of trade marks under the Directive should take account of this particular vulnerability.⁷⁹ This adaptation of the protection in effect secures the capacity of a trade mark to convey this ancillary message.

V. A TRADE MARK'S ECONOMIC "GUARANTEE" OF PRODUCT QUALITY

¶32 While a trade mark's guarantee of trade origin is the legal basis of its capacity to provide quality assurance, it does not provide any such assurance of itself.⁸⁰ The force behind any "guarantee" of quality that it does give is economic and not legal in nature.⁸¹

⁷⁹ On infringement under paragraph (a) of Article 5.1, see *Google France v. Louis Vuitton* (C-236/08) [2010] ETMR 503 ¶¶ 84–85, 89–90; *Die BergSpechte v. Günter Guni* (C-278/08) [2010] ETMR 592 ¶¶ 35–36; on infringement under paragraph (b), see *Sabel v. Puma* (C-251/95) [1998] ETMR 1 ¶¶ 16–18; *Canon v. MGM* (C-39/97) [1999] ETMR 1 ¶ 29; *Lloyd Schuhfabrik v. Klijsen Handel* (C-342/97) [1999] ETMR 690 ¶ 17; *Medion v. Thomson Multimedia* (C-120/04) [2006] ETMR 164 ¶ 26; *O2 v. Hutchison 3G* (C-533/06) [2008] ETMR 853 ¶ 32–36; on Article 5.2, see *Adidas-Salomon v. Fitnessworld* (C-408/01) [2004] ETMR 129; on a third party's ability to rely on the defences under Article 6, see *BMW v. Deenik* (C-63/97) [1999] ETMR 286 ¶ 51; *Gillette v. LA-Laboratories* (C-228/03) [2005] ETMR 825 ¶ 42.

⁸⁰ However, a trade mark should not mislead consumers about the quality of marked products. See *supra* note 53.

⁸¹ See *supra* note 13. See also *Scandecor Development v. Scandecor Marketing* [2001] ETMR 800 ¶ 19 (in which Lord Nicholls commented: "in relying on a trade mark consumers rely, not on any legal

It depends on the trade mark acquiring a reputation in the minds of consumers, on the value of a reputation of this kind as a marketing resource that can enable marked products to command premium prices and on the owner's incentive to increase its value and to not let it decline. Moreover, a trade mark's capacity to provide quality assurance is likely to increase as it gains recognition and positive associations in the minds of consumers.⁸² This progression requires investment and the owner's incentive to secure a return on this investment adds to the force behind the quality assurance. It is for this reason that a trade mark has been portrayed as a "self-enforcing" guarantee of quality.⁸³ The progression of this quality assurance is therefore worth examining in detail.

¶33 A trade mark's legal guarantee of trade origin means that it is possible for marked products to be consistent with each other in terms of quality. In practice, their consistency is likely to depend on the nature of the products in question, on the particular mechanism or mechanisms through which the owner has unitary control over product quality and on how rigorously the owner exercises this power. Subject to these qualifications, a trade mark's signification of likely consistency should give consumers a convenient reference point for communication, search and decision-making about product quality. Such a reference point can be a much more useful and practical basis for these activities than attempting to define and express a desired level of quality in adequate detail (in the sense of specifying a desired combination of product characteristics including the absence of deficiencies). Moreover, by enabling specific products on the market to be linked to a specific undertaking and to its behavior, a trade mark can increase the effectiveness of other mechanisms that are designed to combat information asymmetry through increasing the incentive to comply with these mechanisms.⁸⁴

¶34 However, even with the ease of communication and the ability to acquire information that it facilitates, a trade mark cannot of itself enable consumers to verify the experience and credence characteristics of products (or "unverifiable quality") before purchase or (as the case may be) use or consumption.⁸⁵ And even where the track record of marked products provides some guidance on unverifiable quality, this guidance is limited by the fact that the owner is under no obligation to maintain their consistency or to continue with a particular set of production arrangements that have achieved a particular depth of consistency. Consumers therefore need quality assurance both to provide guidance about unverifiable quality and to counter the risk of a decline in quality. In the absence of quality assurance, consumers would face the risk of disappointment or

guarantee of quality, but on the proprietor of a trade mark having an economic interest in maintaining the value of his mark").

⁸² The rise of the World Wide Web as an arena for the sale and marketing of products has altered the way in which many trade marks gain recognition and a reputation that may provide quality assurance, as well as the way in which consumers use trade marks to facilitate their searches and decision-making. The CJEU has taken account of these developments in its rulings on the scope of the core right of a trade mark owner to prohibit third parties from using it in connection with the marketing of their own products. *Google France v. Louis Vuitton* (C-236/08) [2010] ETMR 503 ¶¶ 84–85, 89–90; *Die BergSpechte v. Günter Guni* (C-278/08) [2010] ETMR 592 ¶ 35–36; *Portakabin v. Primakabin* (Case C-558/08) [2010] ETMR 930; *Interflora v. Marks & Spencer* (C-323/09) [2012] ETMR 1.

⁸³ See Landes & Posner, *supra* note 46, at 270.

⁸⁴ Michael P. Vandenbergh, *The New Wal-Mart Effect: The Role of Private Contracting in Global Governance*, 54 UCLA L. REV. 913 (2007).

⁸⁵ On these characteristics, see *supra* notes 47–51. In the case of experience products including services, it is possible to shift at least some of the risks and other costs of information asymmetry onto the provider through the terms of the transaction.

“adverse selection”: they would have no reason to pay any more for products purporting to have unverifiable quality they desire than they would be willing to pay for products whose quality was no greater than the level they could verify at the time of purchase.⁸⁶

¶35 An undertaking producing or supplying products with significant unverifiable quality would therefore have to accept a sub-optimal price for its products or rely on mechanisms such as an offer to refund the purchase price in the event of disappointment to offset the risk of adverse selection that consumers of its products would face. However, the costs that this would represent can be viewed as investment in building up a good track record for the marked products (which may include responding constructively to consumer disappointment) and, in turn, a good reputation that may encapsulate information about both unverifiable quality and the undertaking’s behavior.⁸⁷ A good reputation reflecting a good track record on these matters should enable an undertaking to charge a higher price for its products than would be possible otherwise, and this premium can be viewed as a return on the investment. Moreover, a good reputation provides quality assurance because the owner has an incentive to maintain or improve it in order to maintain or increase the premium price it can charge.⁸⁸

¶36 In this way, therefore, trade marks create a dynamic incentive for undertakings to maintain or improve the quality of their products and more generally to meet the expectations of consumers. The strength of the incentive at a particular point in time depends on how far the potential benefits of doing this exceed the net potential benefits of pursuing a course of action that may risk damaging the trade mark’s reputation concerning product quality and therefore its value as a source of quality assurance. Such potential damage could take the form of lower product quality, a lower level of likely consistency in the quality of the marked products or an increase in the risk of consumer dissatisfaction, for example by altering the arrangements for producing or procuring the marked products in order to reduce costs. The potential value of a good reputation is likely to increase in line with the lead time that must elapse before any shortfall in quality is likely to become apparent,⁸⁹ but this factor also increases the investment that is likely to be required to generate a good reputation. Moreover, the reputation has to offset the additional risk that the owner could continue to “milk” it for some time and charge a premium price despite a decline in actual product quality. To do this, the trade mark’s value as a marketing resource and therefore the owner’s interest in maintaining or improving it should be high enough to exceed the potential benefit of “milking” it.⁹⁰ Building up this value may not only require a much higher level of investment, but may require investment in something more than building up a good track record.

⁸⁶ See *supra* note 44.

⁸⁷ On how some leading brands have achieved, maintained, or strengthened their attractive power through responding constructively to setbacks and learning from mistakes, see KOEHN, *supra* note 33 at 321–26.

⁸⁸ The capacity of a legal person to acquire a reputation has been recognized as a safeguard against the risks and costs associated with information deficiency and other problems that can make complete contracting prohibitively expensive if not impossible. Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981); Carl Shapiro, *Consumer Information, Product Quality, and Seller Reputation*, 13 BELL J. ECON. 20 (1982); Carl Shapiro, *Premiums for High Quality Products as Returns to Reputations*, 98 Q. J. ECON. 659 (1983).

⁸⁹ Shapiro, *supra* note 89.

⁹⁰ *Id.*

¶37 Investment in one form or another is necessary to generate a trade mark's capacity to provide quality assurance.⁹¹ However, building up a good track record for marked products is not the only kind of investment that can have this effect. The investment should signal an increase in the owner's stake in the trade mark's value as a marketing resource and therefore in its power to attract consumers to marked products on the basis that its continuing appeal is necessary to secure the owner's return on the investment. Its effectiveness also depends on consumers being aware of the extent of the owner's stake in this appeal. Such investment can therefore include expenditure on advertising and other promotional activity such as sponsorship and securing endorsements for the marked products.⁹² In addition to boosting the trade mark's capacity to provide quality assurance, the owner may be able to use investment of this kind to give the trade mark the capacity to confer intangible quality on the marked products.⁹³ The owner may, for example, invest in creating an image or aura for the trade mark or seek to associate it with social status or a particular attitude or set of values.⁹⁴

¶38 The idea that a trade mark can provide quality assurance by being offered as a stake to consumers against the risks and other costs of information asymmetry provides an additional reason for engaging in the practices known as "brand extension" and "brand stretching," which involve using a trade mark (and in effect the brand that the trade mark signifies) to sell products of a similar kind or kinds as those for which it has gained a reputation or even products which are quite dissimilar.⁹⁵ An undertaking can engage in these practices by using or sanctioning the use of the same trade mark or a trade mark that relevant consumers are likely to recognize as signifying an organizational link of some kind.⁹⁶ Engaging in these practices increases the undertaking's return from the trade mark's power to attract consumers, but also increases its vulnerability to bad publicity. The scope for profiting from these practices does not therefore depend on products having characteristics in common or requiring the same kind of expertise to produce or supply, though these factors would reduce the engagement costs of an undertaking including the increased vulnerability of the trade mark's reputation and therefore of its marketing power.

¶39 The quality that a trade mark signifies may therefore relate to the undertaking behind it as well to the marked products. It can provide quality assurance that reflects a good track record in responding to consumer dissatisfaction and adverse publicity as well as the track record of the marked products. For some consumers at least, this may be sufficient to offset a significant risk of disappointment in terms of functional and material quality and especially in the case of a new or "improved" product. Where setbacks and other problems do occur, the extent to which a constructive response to them mitigates the negative impact on the trade mark's attractive power or even strengthens it is likely to depend on how far the problems are due to risks inherent in product development or other

⁹¹ The CJEU's reference to the functions of a trade mark as including "those of communication, investment or advertising" alludes to this importance. See, e.g., *L'Oréal v. Bellure* [2009] ETMR 987 ¶ 58.

⁹² See *supra* note 88; Phillip Nelson, *Advertising as Information*, 82 J. POL. ECON. 729 (1974).

⁹³ Klein & Leffler, *supra* note 89.

⁹⁴ See *supra* notes 33–35.

⁹⁵ These terms tend to be used loosely and interchangeably in the literature on marketing. See, e.g., Jay Pil Choi, *Brand Extension as Informational Leverage*, 65 REV. ECON. STUD. 655 (1998); Lynne M. Pepall & Daniel J. Richards, *The Simple Economics of Brand Stretching*, 75 J. BUS. 535 (2002).

⁹⁶ See *supra* note 79.

forms of innovation as opposed to relaxing previous standards of quality control.⁹⁷ Accordingly, the ability to project “organizational quality” can be a valuable resource for a firm that wishes to engage in innovation. From this perspective, the flexibility of a trade mark’s guarantee of product quality gives the owner some space to improve the marked products or to make other changes which consumers may well come to value, but which involve a significant risk of not doing so.

¶40 The CJEU’s view that trade marks are an essential element in the achievement of a system of undistorted competition is based on their capacity to provide quality assurance in the ways that have been described. This capacity also contributes to improving the long-term competitiveness of undertakings and to promoting innovation, which are major economic goals of the European Union.⁹⁸ In this respect, it is pertinent that the Directive provides additional protection to trade marks that have gained a “reputation” in the minds of consumers that focuses specifically on protecting the value which such trade marks may have acquired as marketing resources.⁹⁹ The CJEU has ruled that this provision should only protect trade marks that have gained a presence in the minds of consumers and only protect such marks from signs that engage with that presence.¹⁰⁰ The owner of a trade mark must prove that, as a result of this engagement, the sign in question has caused damage to the trade mark’s ability to identify products as coming from the owner or to its power to attract consumers or has taken unfair advantage of these attributes and the third party must be unable to show “due cause.”¹⁰¹

¶41 This provision ensures that the protection of trade marks which provide quality assurance can be calibrated with express reference to this capacity, to the various ways in

⁹⁷ It has been argued that an undertaking’s incentive to maintain a good reputation for product quality may discourage it from engaging in radical (as opposed to incremental) forms of innovation. Cole & Matsumiya, *supra* note 14.

⁹⁸ The European Union has declared a commitment to “competitiveness” in its strategies for economic growth, these being the “Lisbon Strategy,” which was launched in 2000 and re-launched in 2005, and the “Europe 2020 Strategy,” which revized the goals of the Lisbon Strategy in the light of the subsequent economic crisis. These strategies emphasized the importance of innovation in improving the competitiveness of firms. See *A Strategy for Smart, Sustainable and Inclusive Growth*, COM (2010) 2020.

⁹⁹ Article 5.2 of the Directive provides that the owner of such a trade mark should be entitled to prohibit an unauthorized third party from using an identical or similar sign in the course of trade “where use of that sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trade mark.” Member States are not obliged to implement this additional protection, but the CJEU has ruled that any Member State which has done so must confer the full scope of the additional protection in accordance with the CJEU’s rulings on its meaning. *Adidas-Salomon v. Fitnessworld* (C-408/01) [2004] ETMR 129. The CJEU has ruled that, to have the necessary “reputation,” a trade mark must be known by at least a significant part of the relevant public (which, depending on the nature of the goods or services for which the trade mark is registered, may be the general public or a specialized section of the public) and throughout at least a substantial part of the relevant territory. *General Motors v. Yplon* (C-375/97) [1999] ETMR 950. Despite its wording, the CJEU has ruled that this provision covers a third party’s use of a sign in relation to products of any kind including those which are identical or similar to those for which the trade mark has been registered as well as those which are “not similar.” *Davidoff & Cie v. Gofkid* (C-292/00) [2003] ETMR 534; *Adidas-Salomon v. Fitnessworld* (C-408/01) [2004] ETMR 129.

¹⁰⁰ In particular, the owner must also show that the third party’s use of its sign (whether it is identical with or similar to the trade mark) leads relevant consumers to make a mental “link” with the trade mark. *Adidas-Salomon v. Fitnessworld* (C-408/01) [2004] ETMR 129 ¶ 29; *Intel Corporation v. CPM* (C-252/07) [2009] ETMR 233 ¶¶ 40–64.

¹⁰¹ On detriment to “distinctive character,” see *Intel Corporation v. CPM* (C-252/07) [2009] ETMR 233 ¶¶ 29, 56, 76; on detriment to “repute,” see *L’Oréal SA v. Bellure NV* (Case C-487/07) [2009] ETMR 987 ¶ 40; on taking “unfair advantage” of these attributes, see *id.* ¶ 49.

which third parties might seek to exploit this capacity, and to the wider economic implications of enabling third parties to do this. This can be seen in particular in the CJEU's portrayal of taking an "unfair advantage" as seeking, without have any due cause for doing so, to ride "on the coat-tails" of a trade mark with a reputation 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."¹⁰²

VI. CONCLUSION

¶42 As product identifiers that are under the exclusive control of one undertaking, trade marks enable undertakings to market their products and to secure specific demand for them. This article has noted two ways in which undertakings can use trade marks to do this, namely to provide assurance about the quality of their products and to confer intangible quality upon them. It has also been seen that in some cases the latter activity can contribute to the former so that the two cannot be entirely separated from each other.

¶43 Using a trade mark to provide quality assurance about marked products enables an undertaking to gain a competitive advantage which may be based both on the quality of its products (including any intangible quality) and on the strength of the assurance that it does provide about their quality. Accordingly, trade marks are an essential feature of a system of competition that encompasses competition based on product quality. They increase the incentives that undertakings have to monitor and improve their systems of quality control and to maintain or improve the quality of their products. Trade marks also provide undertakings with a useful safeguard against some of the risks involved in product improvement and other forms of innovation which may affect product quality and therefore strengthen the incentives to compete through innovation.

¶44 The reasons why undertakings may need to provide quality assurance in order to be able to compete effectively are because products of the same kind can differ from each other in various ways, because consumers may attach value to these differences and be willing to trade them off against price in their decision-making, and because consumers may be unable to discern and evaluate some of these differences at the time of purchase or at least would face substantial costs in order to do so. This article has considered the various characteristics that can contribute to the overall quality of competing products and which therefore offer undertakings various ways to achieve a competitive advantage.

¶45 A related problem is that it may be difficult to specify the entire combination of characteristics that contribute to a product's overall quality (including the absence of various deficiencies), especially when some of these result from the application of tacit knowledge and organizational capabilities that may be unique to a particular undertaking. Trade marks can help both undertakings and consumers to overcome this problem of communication by linking products on the basis that they are likely to be consistent with each other to the extent that can be achieved by one undertaking having unitary control over their quality. However, the quality assurance that a trade mark can provide also has

¹⁰² See *supra* note 13, at ¶ 49.

flexibility which leaves room for product development. In this respect, a trade mark's capacity to signify organizational quality is a valuable component of its overall guarantee of quality.

