TRADEMARK EXTERNALITIES

DAVID W. BARNES*

10 YALE J. L. & TECH. 1 (2007)

ABSTRACT

This Article investigates two particularly intriguing aspects of evolving theories of intellectual property. The first is how well new theories mesh with traditional theories. Externality theory from this decade recapitulates public goods theory from the 1980s. Misappropriation doctrine from 1918 embodies the prescriptions of theory developed decades later. The second is how well theories developed for copyright and patent law, the creativity domain of IP, fit trademark law, the fraud and competition domain. This Article demonstrates that the three approaches to determining the optimal scope of copyright and patent protection involve a balancing of interests equally applicable to trademark issues.

In trademark law, those interests are the creation of incentives to engage in trademarking activity and the use of marks to lower search costs and increase competition. Balancing these interests for any type of use of a mark requires weighing the benefits of exclusive rights and the benefits of free access. Courts that enjoin conduct leading to Internet initial interest confusion tend to focus solely on goodwill, the dynamic efficiency side of the balance. When accepting such claims, courts offer no limits on the internalization of externalities and ignore the inherent balancing. The mixed public goods nature of trademarks means that that the balance between incentives and access might differ for different uses of trademarks. A discussion of Internet initial interest confusion, sponsorship confusion, and post-sale confusion illustrates how to perform this balancing.

* Distinguished Research Professor of Law, Seton Hall University Law School.

TABLE OF CONTENTS

INTRODUCTION

In the traditional perspective, intellectual property law has two domains: the creativity domain and the fraud domain.[1] Copyright law and patent law are about encouraging ideas, creativity, and enlightenment.[2] Expressions of ideas and disclosed innovations are public goods informing the way we think and improving our lives. Trademark law is about commerce, competition, and preventing fraud.[3] Source indicators are private goods producers use to market their goods and services. The contrasting theoretical foundations for these two domains obscure practical solutions to vexing trademark law issues.

This Article highlights the common foundations of copyright, patent, and trademark law. The emerging "externalities" approach to copyright and patent is equally applicable to benefits competitors and consumers obtain from investments in trademarks. The market failures associated with the non-rivalrousness and non-excludability of public goods such as information about expressions of ideas and novel innovations apply to many uses of source indicators. The conflict between monopoly rights and free access inherent in misappropriation theory is as central to understanding the protection of trademarks as it is to copyrights and patents.

Externalities theory has recently emerged as a normative explanation for the structure of copyright and patent law.[4] External benefits are advantages conferred on others without compensation.[5] The lack of compensation prevents those who invest in creation and innovation from maximizing the return on their investment or knowing the full extent of the demand for their activity.[6] Copyright and patent law define the extent to which compensation may be required.

---

[1] *See, e.g.*, Gideon Parchomovsky & Peter Siegelman, *Towards an Integrated Theory of Intellectual Property*, 88 VA. L. REV. 1455, 1463 (2002) (arguing that the theoretically distinct areas of patent and trademark law may be used in complementary ways to extend the life of patents and enhance consumer welfare).

[2] *Id.* at 1468.

[3] *Id*. ("Unlike patent and copyright protection, which seek to spur the creation of inventions and expressive works, trademark protection purports to enhance competition among providers of goods and services.").

[4] *See* Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 265 (2007) (applying externalities theory to copyright and patent law); Jeffrey L. Harrison, *A Positive Externality Approach to Copyright Law: Theory and Application*, 13 J. INTELL. PROP. L. 1 (2005) (applying the theory of externalities to copyright law); *see also* Alina Ng, *Copyright's Empire: Why the Law Matters*, 11 MARQ. INTELL. PROP. L. REV. 337 (2007) (using an externalities approach to develop an institutional and technological analysis of copyright).

[5] ADAM GIFFORD, JR. & GARY J. SANTONI, PUBLIC ECONOMICS: POLITICIANS, PROPERTY RIGHTS, AND EXCHANGE 37 (1979).

[6] *See* Part II, *infra*.

In articles published in 2005 and 2007, Professor Harrison[7] and Professors Frischmann and Lemley[8] applied externality theory to copyright and patent law. They explain why intellectual property law does not and should not compensate creators of original expressions and new and non-obvious innovations for all of the beneficial spillovers from their creative activity. They use externality theory to explain and justify the limits on copyright and patent scope.

Before externality theory, the modern theoretical foundation for copyright and patent law was public goods theory.[9] Public goods are characterized by non-rivalry in consumption and non-excludability.[10] Consumption of information is non-rivalrous because one person's use does not diminish the ability of another to benefit from the information. Information is non-excludable because, once the information has been disclosed, it is difficult to prevent people who have not paid for the information from exploiting it. The policy implication of characterizing a good as a public good is that private markets may not efficiently allocate and encourage the production of public goods.[11] Copyright and patent laws are ways of addressing these market failures.

A simplistic view of the misappropriation doctrine is that people ought not to exploit the labor of others without compensation. The goal is to prevent people from "reaping where they have not sown," from "free-riding" on the efforts of others.[12] For copyright and patent law, this means protecting the author or inventor's right to enjoin others' uncompensated use. In copyright and patent law, the exclusive right to use is circumscribed by limiting the scope of right to defined copyrightable elements and patentable claims, permitting fair use (in copyright), and granting rights for finite terms.

Application of the misappropriation doctrine to copyright and patent illustrates that some free-riding, such as that which occurs after the term has expired, is acceptable. Acceptable free-riding is certainly appropriation, but it is not *misappropriation*. This is the more nuanced

---

[7] Harrison, *supra* note 4.

[8] Frischmann & Lemley, *supra* note 4.

[9] Reference to public goods theory is most common in the legal literature discussing copyright issues, but is also quite familiar to those writing in patent law. For a comprehensive list of articles using public goods theory in both areas, see David W. Barnes, *A New Economics of Trademarks*, 5 NW J. TECH. & INTELL. PROP. 22, 23 n.2. (2006).

[10] *Id.*

[11] Wendy J. Gordon, *Fair Use as Market Failure: A Structural and Economic Analysis of the* Betamax *Case and Its Predecessors*, 82 COLUM. L. REV. 1600, 1610 (1982) ("Economists ordinarily characterize intellectual property law as an effort to cure a form of market failure stemming from the presence of 'public goods' characteristics.").

[12] Int'l News Serv. v. Associated Press, 248 U.S. 215, 239 (1918).

view of misappropriation doctrine presented in the classic Supreme Court case *International News Service v. Associated Press*.[13]

Trademark law's historical roots in fraud and competition law obscure the similarities among the signals embodied in trademarks, tangible expressions of ideas, and disclosed innovations. Trademark infringers free ride on the investments of trademark owners and misappropriate owners' goodwill. But competitors' fair use of another's trademark for comparative advertising is acceptable appropriation, desirable free-riding on another investment in information.[14] Consumers' use of trademarks in searching for goods is non-rivalrous, non-excludable, and desirable. These are external benefits of trademarking activity, just as fair use and post-term use are external benefits of original expressive and innovative activity.

Trademarks are mixed public goods. Competing proprietary (source-indicating) uses of marks are rivalrous, but consumers' referential uses are non-rivalrous. A trademark owner may include the cost of trademarking in sales price and internalize some of the benefits, but competitors and rejecting consumers never pay the price for using that information. The public goods character of these uses of trademark suggests that markets may not efficiently allocate resources to the production of information about the sources and characteristics of products and services. These similarities suggest that the theoretical approaches to the scope of copyright and patent may fruitfully be applied to trademark policy.

This Article combines these two theoretical perspectives and the doctrinal perspective of the misappropriation doctrine to determine the appropriate scope of trademark law in controversial areas. Relying on the outlines of a misappropriation doctrine analysis, the Article considers the extent of market failure arising from the mixed public goods nature of trademarks and the desirability of permitting uncompensated spillovers

---

[13] *Id.*

[14] *See, e.g.*, August Storck K.G. v. Nabisco, Inc., 59 F.3d 617, 619 (7th Cir. 1995) (concluding that, by ignoring the benefits of comparative advertising, the district court had given insufficient consideration to the public interest in promoting competition):

> Both the FTC and the FDA encourage product comparisons. The FTC believes that consumers gain from comparative advertising, and to make the comparison vivid the Commission 'encourages the naming of, or reference to competitors.' 16 C.F.R. § 14, 15 (b). A 'comparison' to a mystery rival is just puffery; it is not falsifiable and therefore is not informative. Because comparisons must be concrete to be useful, the FDA's regulations implementing the Nutrition Labeling and Education Act of 1990, 21 U.S.C. § 301, prefer that the object of a nutritional comparison be the market leader (a 'comparison' to a product consumers do not recognize is as useless as a comparison to an anonymous rival) or an average of the three leading brands. 21 C.F.R. § 101.13(j) (1) (ii) (A).

Id. at 618.

from trademarking activity. The analytical method is focused on Internet initial interest confusion, with passing reference to sponsorship and post-sale confusion.

The basic challenge for intellectual property law is finding the optimal scope of rights that simultaneously encourages creativity by exclusive rights and permits widespread use through free access. Recent application of the economics of externalities to copyright and patent recommends tailoring incentives to optimize production of information at minimum cost in terms of denial of access. Part II of this Article extends the analysis of external effects to trademarks. Part II.A identifies those effects of trademarking activity that are internalized while Part II.B identifies external benefits. The existence of an external benefit is both a practical and legal question. Some activities by their nature have only insignificant external benefits if any. Practically speaking, the benefits of my eating a peach are all internalized to me. Other activities are designed to produce external benefits, such as my publishing this Article. But whether a benefit stays "external" depends on the law, which regulates which beneficiaries are obliged to pay for the benefits. Thus, the classification of trademark's benefits as internal or external depends on what uses people make of trademarks and the extent to which they are obliged to compensate trademark owners for the benefits they receive.

Part III presents operational rules for internalizing copyright and patent externalities and extends externality theory to trademark law. Part III.A discusses Professor Jeffrey Harrison's externalities analysis of copyright law and his approach to optimizing access to expressions of ideas. It illustrates his approach and extends it to trademark law. Part III.B discusses Professors Brett Frischmann and Mark Lemley's externalities analysis of copyright and patent law. They offer a supply and demand perspective on externalities that readily meshes with the traditional public goods theory of intellectual property. In their view, the scope of IP protection is dictated by necessary incentives. Beyond that, free access to expressive and innovative work is desirable. Part III.C discusses irrelevant externalities, external benefits that should be ignored when evaluating the scope of trademark protection. Trademark law would decline to enjoin uses when doing so would not increase trademarking activity or the benefits obtained from trademarking activity.

The traditional public goods approach to intellectual property anticipates the descriptive and normative conclusions of externalities theory. Part IV explains the overlap between these two approaches. It describes the public goods nature of trademark externalities and sets the stage for the development of a set of operational rules for determining the optimal scope of trademark protection.

Part V offers an externalities interpretation of the Supreme Court's seminal opinion in *International News Service v. Associated Press, Inc.*[15]

[15] 248 U.S. 215 (1918).

International News Service created the common law foundation for misappropriation theory and described a theoretical basis for protecting rights in intangible property. Part V.A describes the Supreme Court's balancing approach in terms that reflect the operational rules derived from externality and public goods theories. Part V.B revisits the operational rules derived from externality and public goods theories and presents a five-step approach to determining the optimal scope of trademark law.

Part VI applies the operational rules developed in Part V to trademark cases in which courts rely on claims of free-riding to support injunction. The approach is first illustrated in Part VI.A in the context of a traditional trademark infringement case, where a competitor passes off its goods as those of another by using the other's mark as a source indicator. It is then applied in detail in Part VI.B to the class of cases involving allegations of initial interest confusion on the Internet. Part VI.C briefly considers sponsorship and post-sale confusion. Applying the operational rules developed in this Article shows the weakest case for injunctions in Internet initial interest confusion cases and somewhat greater support for enjoining activity giving rise to sponsorship and post-sale confusion.

I. FREE-RIDING AND EXTERNALITIES OF TRADEMARKING ACTIVITY

We typically justify the scope of protection given to any type of intellectual property by the benefits generated by creative expressions, innovations, and information. The investment in productive activity alone does not justify intellectual property monopolies; it is the fruit of the investment that merits protection.[16] By its nature, information is susceptible to a variety of uses by a variety of people. Whether the benefits of information are external or internal to the creator depends on the structure of the law.

Fully enforced, comprehensive exclusive rights theoretically permit a creator of information to obtain the full value of all the benefits flowing from his or her investment. By estimating those anticipated benefits, the creator may gauge how much investment of time and resources in the creative activity is justified. Those benefits are internal to his or her calculus.

External benefits are derived by people who are not obliged to compensate the creator. Because free riders produce no return on

---

[16] *See, e.g.*, Mazer v. Stein, 347 U.S. 201, 219 (1954), *superseded by statute*, 1976 Copyright Act, Pub. L. No. 94-533, 90 Stat. 2541, *as recognized in* Fabrica, Inc. v. El Dorado Corp., 697 F.2d 890 (9th Cir. 1983) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of author and inventors in 'Science and useful Arts.'"); *see also* Lorin Brennan, *Financing Intellectual Property Under Revised Article 9: National and International Conflicts*, 23 HASTINGS COMM. & ENT. L.J. 313, 319 n.7 (2001) (quoting additional sources); Harrison, *supra* note 4, at 1 n.4 (quoting other judicial articulations of this premise).

investment, they do not affect a rational creator's calculation of how much to invest. Because others may use the creation without compensation, there is no market in which they would reveal their willingness to pay for those benefits. The creator does not and sometimes, for lack of information, cannot take external benefits into account.

The existence of externalities suggests the potential for one market failure: failure to provide proper incentives for creative activity.[17] This is only a *potential* problem because internal benefits may be sufficient motivation.[18] A poet or musician may write or play to please himself or make enough money from performances to encourage his creativity.[19] An inventor may save so much from employing a new production process that compensation from others who use the idea is not necessary to encourage her investment. Professors Kal Raustiala and Christopher Sprigman have argued, for instance, that the structure of the fashion design industry is such that intellectual property protection for fashions is unnecessary.[20] Then-Professor Breyer argued that the case for copyright protection for book publishing based on incentives is weak.[21] Whether there actually is sufficient incentive in a particular industry without internalization of all external benefits requires analysis of the industry.

External benefits may also give rise to a second market failure by making it hard to determine the demand for creative activity. If computer users can download music without paying, it is difficult for record companies to know how much people are willing to pay for their recordings. If there is no revelation of this demand, a private market does not have the proper signals to adjust supply to demand.[22]

Recognition that external benefits create only the *potential* for market failure is often illustrated by the example of a homeowner planting

---

[17] *See* Frischmann & Lemley, *supra* note 4, at 258; Harrison, *supra* note 4, at 10; Ng, *supra* note 4, at 353-54.

[18] Ng, *supra* note 4, at 350-52, offers the example of the returns earned by J.R.R. Tolkien for writing *The Lord of the Rings* series and selling fifty-two million copies, suggesting that these internalized returns were sufficient to motivate the author. The additional $2.92 billion in revenues earned by the three movies based on the books was unnecessary to motivate the author and, if internalized, might discourage the production of derivative works.

[19] *See* Raymond Shih Ray Ku, *The Creative Destruction of Copyright: Napster and the New Economics of Digital Technology,* U. CHI. L. REV. 263, 306-11 (2002) (describing incentives available to musicians outside of copyright protection).

[20] Kal Raustiala & Cristopher Sprigman, *The Piracy Paradox: Innovation and Intellectual Property in Fashion Design*, 92 VA. L. REV. 1687 (2006).

[21] Stephen Breyer, *The Uneasy Case for Copyright in Books, Photocopies, and Computer Programs*, 84 HARV. L. REV. 281 (1970).

[22] *See* Barnes, *supra* note 9, at 40-43; Frischmann & Lemley, *supra* note 4, at 279-80.

flowers in his front yard.[23] The flowers benefit not only the homeowner but those walking by and those whose homes are nearby. The homeowner may even take pleasure in the pleasure of others, "but generally the homeowner does not seek compensation or take into account the summed benefits for all. Neither the law nor economic efficiency require[s] complete internalization."[24] But without requiring compensation, there is no way for the homeowner to know how much benefit he is conveying on his neighbors. There is no market to reveal the total demand for flower-growing activity.

Limits on the scope of all intellectual property protection, which may be broadest in trademark law, permit many users of trademarks to enjoy the fruits of trademarking activity without paying the trademark owner. Recognizing these positive externalities, this Article explores the fruits of trademarking activity, the scope of protection justified by those benefits, and the appropriate contours of trademark law.

Trademarking activity is investment in supplying source-identifying and product-characterizing information. The fruits of trademarking go beyond reducing the search costs of purchasers of trademarked goods. These purchasers pay for trademarking with higher prices.[25] Other consumers who rely on the information contained in the

---

[23] *See* Brett M. Frischmann, *An Economic Theory of Infrastructure and Commons Management*, 89 MINN. L. REV. 917, 939-56 (2005) (discussing public goods theory and comparing impure public goods); Frischmann & Lemley, *supra* note 4, at 258; Mark A. Lemley, *Property, Intellectual Property, and Free Riding*, 83 TEX. L. REV. 1031, 1048 n.75 (2005) (discussing the perspective on intellectual property law that would permit creators to appropriate the full social value of their creations). The simple flower garden of the Frischmann article is a "magnificent English garden that people comes from miles around to see." Harrison, *supra* note 4, at 9. *See also* Terry L. Anderson & J. Bishop Grewell, *Property Rights Solutions for the Global Commons: Bottom-Up or Top-Down?*, 10 DUKE ENVT'L L. & POL'Y F. 73, 75 n.7 (1999) (discussing the environmental commons); Richard A. Epstein, *The Allocation of the Commons: Parking on Public Roads*, 31 J. LEGAL STUD. 515, 520 (2002) (discussing Demsetz theory of the allocation of property rights); Lee Anne Fennell, *Common Interest Tragedies*, 98 NW. U. L. REV. 907, 915, 943 (2004) (discussing the allocation and management of common pool resources and describing lack of compensation for external effects as "blinders" that do not permit the actor to see the effects of his or her conduct); David D. Haddock, *When Are Environmental Amenities Policy-Relevant?*, 44 NAT. RESOURCES J. 383, 412 (2004) (discussing incentives to create environmental amenities); Louis Kaplow, *Fiscal Federalism and the Deductibility of State and Local Taxes Under the Federal Income Tax*, 82 VA. L. REV. 413, 482 (1996) (discussing deductibility of personal expenditures based on positive externalities created); F. Scott Kieff, *Coordination, Property, and Intellectual Property: An Unconventional Approach to Anticompetitive Effects and Downstream Access*, 56 EMORY L.J. 327, 401 n.255 (2006) (discussing incentives to create); Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavior Gender Biases in the Code*, 40 UCLA L. REV. 983, 1048 (1993) (discussing gender bias in the tax code).

[24] Frischmann, *supra* note 23, at 967.

[25] *See* William M. Landes & Richard A. Posner, *The Economics of Trademark Law*, 78 TRADEMARK REP. 267, 277 (1988):

trademark reject the supplier's good. Competing suppliers of goods engaged in comparative advertising[26] or in remanufacturing of goods,[27] as well as social commentators, are encouraged or allowed to benefit from another's trademarking activity without paying.[28] The existence of these uncompensated positive externalities suggests, but does not by itself prove, that mark owners will produce too little information about their products.

Part II.A discusses internalized benefits of trademarking activity – benefits for which the mark owner receives compensation. Part II.B discusses currently uncompensated externalized benefits of trademarking. The goal is to demonstrate that many people free ride on the trademark owner's investment and to raise the question of when compensation should be paid.

A. INTERNALIZED BENEFITS OF TRADEMARKING ACTIVITY

The obvious internalized benefit from trademarking activity is the enhanced revenues obtained by the trademark owner and its licensees due to increased sales. It is well-recognized that buyers benefit from trademarking activity and pay for that activity through higher prices. Posner and Landes sensibly observed that consumers are willing to pay more for goods that are more likely to satisfy their needs.[29] The mark provides this assurance. I might buy five pairs of walking shoes before finding one that is still comfortable after the first few miles. Having found that pair, I am willing to pay more to ensure that the next pair is made by the same supplier, as a way of avoiding the risk of wasting money on an unsatisfactory product. Consumers gain something by paying for assurance of higher quality. If they can rely on a mark as a consistent

---

> 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.

[26] *See supra* text accompanying note 14.

[27] *See, e.g.*, Champion Spark Plug Co. v. Sanders, 331 U.S. 125, 130 (1947):

> The result is, of course, that the second-hand dealer gets some advantage from the trade mark. But under the rule of Prestonettes, Inc., v. Coty, *supra*, that is wholly permissible so long as the manufacturer is not identified with the inferior qualities of the product resulting from wear and tear or the reconditioning by the dealer. Full disclosure gives the manufacturer all the protection to which he is entitled.

[28] *See, e.g.*, Mattel, Inc. v. Walking Mountain Prods., 353 F.3d 792, 807 (9th Cir. 2003) (holding that the public interest in free and artistic expression greatly outweighed the trademark owner's interest in potential consumer confusion about the owner's sponsorship of an artist's work).

[29] *See* Landes & Posner, *supra* note 25.

signal of the qualities and characteristics of a good, they can save time (reduce search costs) by looking for goods with that mark affixed.

Trademark owners can internalize the costs of trademarking activity only if consumers are willing to pay for the product information and quality assurance conveyed by the mark. Consumers benefit only if they can rely on the mark as a signal that the good has the characteristics associated with the mark. If competitors with goods of varying qualities and characteristics can affix the same mark to their goods, consumers can no longer rely on the mark as a signal. Concurrent competitive use of a mark increases consumers' cost of searching for goods that satisfy their preferences and diminishes their willingness to pay for the signals the mark provides.

Similarly, trademarking activity informs first-time buyers by describing the qualities and characteristics of the products. Knowing that Extra Strength Exedrin pain reliever made by Novartis contains caffeine[30] may induce me to buy the product because I appreciate the mind-altering effects of caffeine. Knowing that a Big Mac sold by McDonald's has two all-beef patties and special sauce might induce me to purchase one if I think two patties are better than one.[31] Providing such information raises the cost of supplying the product, which a rational seller will attempt to pass on to customers. The rational seller will decide to produce more information if the cost of doing so is less than the additional revenue the seller earns. So we can expect a trademark owner to supply revenue-maximizing information. First-time buyers, perhaps relying on the product information revealed by trademarking activity, will purchase the goods if the anticipated benefits exceed the price, including the passed-on cost of trademarking activity.[32]

The bottom line is that there is a market for the information produced by trademarking activity. Successful trademark owners cover the cost of their trademarking activity through higher prices charged to purchasers of their goods. Purchasers are willing to pay for the benefit trademarking activity provides when making their purchasing decisions.

---

[30] *See* http://www.excedrin.com/products/.

[31] One might also want to know that a Big Mac contains 1040 milligrams of salt (most in the bun and the grill seasoning) and twenty-nine grams of fat. *See* http://app.mcdonalds.com/bagamcmeal. One might also want to know the health implications. This type of information is unlikely to be forthcoming even if McDonald's had more revenue with which to supply the information. Professor Goodman reports that companies did not widely disclose nutritional information until federal regulation required it. Ellen P. Goodman, *Stealth Marketing and Editorial Integrity*, 85 TEX. L. REV. 83, 139 (2006) (citing MARY GRAHAM, DEMOCRACY BY DISCLOSURE 77-84, 101-03 (2002) (describing the evolution of the federal nutrition labeling requirement)).

[32] The higher price resulting from increased trademarking activity is not pure profit for the supplier. Some portion of that revenue goes to paying for the cost of providing information about its product and strengthening the link between its product and its mark as indicating the origin of the product. Novartis and McDonalds pay for advertising the qualities and characteristics of their products and for maintaining consistent quality.

Those benefits are internalized to the supplier's production decisions because the supplier is compensated for providing that information.

The trademark information market is not, however, a perfect market. Purchasers are not the only parties that benefit from the trademarking activity by making referential use of the mark. People who refer to the information provided by the trademark owner and decline to buy the good, people who use the mark to refer to the good (and implicitly its characteristics and qualities) in conversation, and people who engage in comparative advertising or social commentary benefit without paying. These uncompensated benefits are external to the trademark owner's decision-making.

B. EXTERNALIZED BENEFITS OF TRADEMARKING ACTIVITY

Many, perhaps most, referential users of trademarks free ride on the trademark owner's investment. Referential users of a mark do not use the mark to indicate that they are the source of goods to which the mark is affixed. Rather, they use the mark to refer to the goods of the trademark owner. Referential users stand in contrast to proprietary users, those who use the mark to indicate that they are the source of the goods to which the mark is affixed. Traditional infringement cases involve competitors whose proprietary use of another's mark deceives or confuses consumers about the source of the goods. Referential use is generally permitted.

Consumers who reject a good or service based on the source or characteristics and qualities information conveyed by the mark benefit from the owner's trademarking activity without paying. The owner's investments inform rejecting consumers that the good will not meet their needs (as Coke will not meet the needs of a Diet Pepsi drinker). The same can be said for suppliers of goods who use the owner's mark to identify the owner's goods for the purpose of comparison ("two Extra Strength Bayer aspirin are as effective as Tylenol with Codeine and much less expensive"[33]), or description ("Bacardi Rum tastes great with Coke," "contains reconditioned and refurbished Titleist golf balls"[34]). Daily discourse similarly benefits from reference to brands, as this paragraph illustrates, as does artistic expression (as Warhol's Campbell Soup can paintings commented on then-prevailing artistic standards).

The benefits each of these free-riding users derives from the owner's investment is external to the owner's revenue and cost calculus

[33] http://www.bayeraspirin.com/pain/tylenol.htm.

[34] Nitro Leisure Prods., L.L.C. v. Acushnet Co., 341 F.3d 1356, 1366 (Fed. Cir. 2003) (affirming district court's denial of preliminary injunction requested by holder of Titleist trademark alleging trademark infringement and dilution by golf ball reconditioner).

because the users do not pay for the benefits they obtain.[35] Because the trademark owner who creates these external benefits receives no compensation for doing so, his or her incentive to create is limited to the compensation he or she receives from the purchasing consumers who pay a higher price that reflects the cost of trademarking activity. The lack of full compensation potentially leads to a sub-optimal amount of benefit-creating activity.[36]

In the legal literature generally[37] and in copyright law specifically,[38] the inability to internalize external benefits is routinely characterized as a market failure. Information provision, such as that provided by trademarking activity, is an example of a type of good that

---

[35] Economists recognize that external effects "exist when the activity of one party benefits (damages) another party that does not pay (receive compensation) for the benefit (damage)." GIFFORD & SANTONI, *supra* note 5, at 37.

[36] *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 411 (1988).

[37] Consideration of external benefits and sub-optimal provision of goods appears in a diverse cross-section of the legal literature. *See, e.g.*, Scott Altman, *A Theory of Child Support*, 17 INT'L J. L. POL'Y & FAM. 173, 186 n.64 (2003) (considering whether subsidies may adequately internalize internal benefits of producing children); Aaron-Andrew P. Bruhl, *Public Reason as a Public Good*, 4 J. L. SOC'Y 217, 239 (2003) (arguing that there may be insufficient incentive to adopt public reason as a social norm because some of the benefits of doing so are external to the actor); Thomas A. Lambert, *Avoiding Regulatory Mismatch in the Workplace: An Informational Approach to Workplace Safety Regulation*, 82 NEB. L. REV. 1006, 1031 (2004) (attributing a failure of employers to adopt cost-effective precaution to sub-optimal production of external-benefit-producing information about available precautions).

[38] *See* Stewart E. Sterk, *Intellectualizing Property: The Tenuous Connections Between Land and Property*, 83 WASH. U.L.Q. 417, 467 (2005):

> Ordinarily, propertization of resources is extolled for its ability to internalize externalities; if a property owner can capture all external benefits created by the resource, the owner is more likely to use the resource efficiently. When the resource is non-rival, however, complete propertization may result not in the capture of external benefits, but in their dissipation. The owner will typically charge a positive price for the resource even though the marginal cost of distributing another unit is zero, resulting in a deadweight loss. Avoiding this loss serves as a foundation for the doctrinal limitations on copyright protection--durational limits, fair use, and first sale among them.

See also Alfred C. Yen, *A Preliminary Economic Analysis of Napster: Internet Technology, Copyright Liability, and the Possibility of Coasean Bargaining*, 26 U. DAYTON L. REV. 247 (2001) (considering the extent to which internalization of externalities by giving Napster rights to prevent uncompensated file sharing is necessary to prevent inefficiency); Lydia Pallas Loren, *Redefining the Market Failure Approach to Fair Use in an Era of Copyright Permission Systems*, 5 J. INTELL. PROP. L. 1 (1997) (arguing that fair use of copyrighted works produces external benefits and that should inform the scope of fair use protection).

may be undersupplied. The question for trademark law is what to do about this potential "systematic informational deficiency."[39]

III. INTERNALIZING COPYRIGHT AND PATENT EXTERNALITIES

Formal application of externality theory to intellectual property law came in articles on copyright and patent law published in 2005[40] and 2007.[41] These articles illustrate ways in which copyrighted and patented works produce external benefits, argue that copyright and patent law *should not* internalize all externalities, and illustrate how copyright and patent law *do not* allow compensation for all external benefits. They provide guidelines for balancing the beneficial effects of exclusive rights with the beneficial effects of free access.

The authors of the two articles conclude that exclusive rights ought to be limited to the extent necessary to provide incentives to engage in creative activity. Part III.A describes the operational rules developed by Professor Jeffrey Harrison, illustrates their application in the copyright context, identifies the costs associated with the grant of exclusive rights, and translates the theory into the trademark law context. Part III.B interprets these operational rules in a supply and demand framework developed by Professors Frischmann and Lemley, applies them to patent law, and describes trademark law analogies. Part III.C discusses those external effects that *should not* be internalized because they are irrelevant to or at odds with relevant policy goals. In trademark law, rights assignments that do not affect the incentive to engage in trademarking activity, that increase search costs, or that harm competition are at odds with trademark policy.

A. OPERATIONAL RULES

In a 2005 article, Professor Jeffrey Harrison used externality theory to develop operational rules for copyright issues.[42] The fundamental idea is that copyright law awards the possibility of a financial reward to a creative person in a manner designed to maximize benefit to society.[43] He demonstrates this through the application of two related rules: (1) protect works only when doing so creates more social benefits than costs and (2) incur no greater social cost than necessary to provide incentives to the

---

[39] The term "systematic information deficiency" is adopted from Professor Lambert's use in an article about workplace safety and information about available precautions. Lambert, *supra* note 37.

[40] *See* Harrison, *supra* note 4.

[41] *See* Frischmann & Lemley, *supra* note 4.

[42] *See* Harrison, *supra* note 4, at 13.

[43] *Id*.

creator.[44] These rules reflect the basic idea that, while creative work is to be encouraged, "private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and the other arts."[45]

While broad exclusive copyrights maximize the possibility of reward, exclusive rights are costly. Costs include the administrative expense of protecting copyrights, the transaction costs of negotiating for access to protected works, and the deadweight loss associated with exclusion of people unwilling to pay the price demanded.[46] If the goal is to maximize net social gains from creative activity, something less than complete internalization of externalities is appropriate.

A scope of copyright that is too broad limits public access too much. The challenge is to find the scope of rights that simultaneously encourages creativity and external benefits – the optimal balance between exclusive rights and public access. If an increase in creative activity accompanying a larger scope of copyright is accompanied by even greater increase in costs, the scope of rights should not be expanded.[47] For example, expressive works with only modest creative content — those with only a "modicum" of creativity — receive only thin copyright protection.[48] The social cost of exclusive rights is tailored to match the social benefit associated with the creative activity.

Translating to the trademark context, the basic idea is that protection of a mark owner's investment in goodwill must ultimately serve the cause of promoting competition and benefiting consumers. This is achieved by expanding the scope of trademark rights (protecting goodwill) only when doing so produces a net social benefit. The expected value of increased information must be balanced against the associated costs of denying access. The cost of increasing the scope of rights includes the costs of registering and enforcing trademark rights, the transaction costs associated with obtaining permission to use others' marks, and the harm to referential users of marks from denying access. The challenge for trademark law is to find the optimal balance between proprietary and referential rights.

---

[44] *Id.* at 6.

[45] Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975).

[46] *See* Harrison, *supra* note 4, at 13-14.

[47] *See id.* at 14.

[48] *See generally id.* at 15 (interpreting Feist Publ'ns. v. Rural Tel. Serv. Co., 499 U.S. 340 (1991)). "The notion of 'thin' in copyright law refers to the fact that works with little creativity have only slight protection." Harrison, *supra* note 4, at 19.

B. THE OPERATIONAL RULES IN A SUPPLY AND DEMAND FRAMEWORK.

In 2007 Professor Brett Frischmann and Mark A. Lemley argued for balancing exclusive rights and public access using an externalities approach to patent and copyright issues.[49] Their conclusion was that complete internalization of externalities is not always necessary[50] and that the social costs of relying on expanding the scope of copyright and patent rights may exceed the benefits.[51] With this conclusion, Frischmann and Lemley provide support for Harrison's operational rule that it is desirable "to protect only works that create more social benefit than social cost."[52]

Frischmann and Lemley illustrate the balancing process by reference to principles of copyright and patent law. For example, they observe that copyright law does not protect ideas, themes, or facts. The social costs of such protection, in terms of its "essential role in socially valuable processes,"[53] presumably exceed the benefits in terms of additional incentives. Copyright's fair use provisions protect uses that have such widespread social utility that, even if the social value of each person's use of the copyrighted work is small, the cumulative value is

---

[49] Frischmann & Lemley, *supra* note 4, at 257 ("This new theory has significant potential as an alternative economic theory to understand IP as well as other areas of the law."). Taking the externalities approach may be strategic for two reasons. First, their previous scholarship illustrates Frischmann and Lemley's intimate familiarity with applications of public goods theory to intellectual property issues. *See, e.g.*, Frischmann, *supra* note 23, 939-956; Mark A. Lemley, *Ex Ante Versus Ex Post Justifications for Intellectual Property*, 71 U. CHI. L. REV. 129, 129-30 (2004); Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 997 (1997); Mark A. Lemley & David W. O'Brien, *Encouraging Software Reuse*, 49 STAN. L. REV. 255, 268 (1997). And they are aware of the demand and supply side implications of the market failure associated with public goods. *See, e.g.*, Frischmann, *supra* note 23, at 939-56; Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 533 n.232 (1998). Second, it is very useful to look at old problems from new perspectives. By recasting the public goods argument as an externalities argument, Frischmann and Lemley make their appeal for limits on the scope of intellectual property rights appear to be yet another argument while undoubtedly recognizing that creating public goods by definition creates the potential for external benefits because of their non-rivalrous character. *See* GIFFORD & SANTONI, *supra* note 5, at 37 ("Public goods create what are called externalities."). Their "alternative economic theory," Frischmann & Lemley, *supra* note 4, at 257, allows them to rephrase the public goods arguments in a manner that might be more appealing to or understandable by some readers.

[50] Frischmann & Lemley, *supra* note 4, at 258 ("We suggest that there is no reason to think that complete internalization of externalities is necessary to optimize incentives.").

[51] *Id.* ("We observe that even where internalizing externalities increases incentives to invest, the social costs of relying on property rights to do so still may exceed the benefits.").

[52] Harrison, *supra* note 4, at 6. The demand side argument is addressed to social benefits and the supply side argument is addressed to social costs. *See* Frischmann & Lemley, *supra* note 4, at 271.

[53] Frischmann & Lemley, *supra* note 4, at 286.

great.[54] Fair use analysis in copyright includes both social benefits of free access and cost to the creator in terms of diminished incentives.[55] Fair use is less likely to be allowed, other things equal, where the use is commercial and detrimentally affects the creators' ability to earn compensation,[56] but both benefits and costs are balanced.

Their conclusion that full internalization is inappropriate has supply-side and demand-side arguments. On the supply side, Frischmann and Lemley argue that creators only need to be given "enough" incentive and something less than full internalization may achieve that goal.[57] The argument reflects Harrison's operational rule that it is desirable to incur "no greater social cost than necessary to encourage the production of copyrighted work."[58] They argue that "society needs merely to give them enough incentive to cover the fixed costs of creation that their imitators will not face.[59] Additional compensation may produce no additional investment in creation[60] or may not promote innovation as much as if others were free to adapt the creation to other uses, [61] even if licensees are permitted to develop the creation.[62]

On the demand side, Frischmann and Lemley start with the generally recognized proposition that external benefits distort allocative efficiency because creators do not take those benefits into account when deciding how much to invest in creation.[63] While competitive markets generally reveal consumers' willingness and ability to pay for goods and services, they do not reveal the full social value of the goods or services or allow suppliers to obtain compensation equal to that full social value.[64] The full social value would deprive buyers of all consumer surplus: "If we calibrate IP rights properly, the disparity between the incentive needed to

---

[54] *Id.* at 288.

[55] *Id.* at 289.

[56] *Id.*

[57] *Id.* at 276. Frischmann and Lemley's argument has three parts: (1) the observation that giving additional compensation to a particular innovator does not always encourage more innovation because the present return on investment is sufficient, *id.* at 276-77; (2) that competition rather than monopoly for development of a particular idea may be preferable, *id.* at 277-78; and (3) that the option of licensing others to improve on or exploit the idea may not lead to full internalization, *id.* at 278-79.

[58] Harrison, *supra* note 4, at 6.

[59] Frischmann & Lemley, *supra* note 4, at 276.

[60] *Id.*

[61] *Id.* at 277.

[62] *Id.* at 278.

[63] *Id.* at. 279.

[64] *Id.*

motivate research and the full social benefit of an innovation will show up as spillovers."[65] Consumer surplus is an example of such a spillover.[66]

In their discussion of patent law, Frischmann and Lemley discuss the applicability of the doctrine of equivalents to unforeseeable, later-developed technologies. On the supply side, extending patent protection to uses and developments the inventor could not have foreseen may not promote innovation as much as if others are allowed to "tinker with or repurpose"[67] inventions. On the demand side, an innovator examining the market for her invention may be unable to internalize the demand for unforeseeable future uses and developments. Accordingly, patent law should "balance the incremental incentive created by the prospect of a broad right extending into unforeseen territory against the potential that broad application of the doctrine will restrict improvers who cannot effectively bargain for those rights."[68] The balancing process includes the benefits from increased incentives and the benefits from access.

There are straightforward analogs to these market failures in trademarks. On the supply side, giving greater incentives to produce information through internalization may not yield the information consumers desire – such as more information about the limitations of a product's performance and the characteristics some consumers may consider undesirable.[69] Nor will it produce advertising favorably comparing a competitor's product to the mark owner's product or produce information accurately describing a repaired or remanufactured item as having originally been manufactured by the mark owner. The mark owner is not in the best position to appreciate the social benefits of these uses and probably would not license them if it had the option.

On the demand side, the ability of mark owners to determine the demand for product and source information is limited. Purchasing consumers reveal their demand for information by their willingness to pay the cost of marketing that is included in their price. But other referential users, including competitors engaged in fair use of the mark and consumers who use the mark to reject particular goods do not reveal the value they derive from the mark owner's investment.[70] Thus, the general

---

[65] *Id.* at 283.

[66] Consumer surplus is the difference between the maximum a buyer is willing and able to pay and the price he or she actually pays. It measures the consumer's improvement in well-being due to the purchase. DAVID W. BARNES & LYNN STOUT, CASES AND MATERIALS ON LAW AND ECONOMICS 364-65 (1992).

[67] Frischmann & Lemley, *supra* note 4, at 292.

[68] *Id*.

[69] *See* Barnes, *supra* note 9, at 58-59 (discussing failures in the market for trademark information).

[70] Barnes, supra note 9, at 53 *et seq*. Barnes concludes:

balancing approach to the scope of copyright and patent applies to trademark as well.

C. IRRELEVANT EXTERNALITIES

Much of the scholarly literature discussing the approach to property rights and the internalization of externalities offered by Harrison, Frischmann, and Lemley is based on a 1962 work by Professors Buchanan and Stubblebine simply titled *Externality*.[71] This literature distinguishes between those "relevant" externalities that ought to be taken into account in policy analysis and "irrelevant" externalities that ought to be discounted.[72] Irrelevant externalities are those external benefits that should not be internalized.

Internalizing external benefits from the information embodied in creative activity generally creates a deadweight loss. Granting exclusive rights generally increases the creator's revenues and incentives to create. But denying access generally causes a loss to people who could benefit from the information already produced. Suppliers may deny access by charging a price for information that additional consumers could have consumed at no cost. The deadweight loss is a measure of the benefits

---

> In sum, there are three market failures associated with trademarks. First is a market failure created by non-excludability, free riding that interferes with the ability to recoup costs, which is addressed by creating exclusive rights. Second, there a market failure created by the static/dynamic dilemma, the deadweight loss associated with excluding some would-be purchasers due to higher price that includes costs of trademarking. This is unaddressed by trademark law, but may be considered a worthy tradeoff for providing incentives to suppliers of search information. Third, there is the market failure created by lack of demand revelation, which is unaddressed by trademark law.

Id., at 62.

[71] James M. Buchanan & Wm. Craig Stubblebine, *Externality*, 29 ECONOMICA 371 (1962) (cited in Frischmann & Lemley, *supra* note 4, at 276 n.68). Among others relying on the Buchanan/Stubblebine conclusion in a variety of legal contexts are Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 539 n.170 (2001); Steven J. Eagle, *Environmental Amenities, Private Property, and Public Policy*, 44 NAT. RESOURCES J. 425, 428-29 (2004); Fennell, *supra* note 23, at 942 n. 146; Lee Anne Fennell, *Efficient Trespass: The Case for "Bad Faith" Adverse Possession*, 100 NW. U. L. REV. 1037, 1068 n.130 (2006); Israel Gilead, *Tort Law and Internalization: The Gap between Private Loss and Social Cost*, 17 INT'L REV. L. & ECON. 589, 590 n.3 (1997); Haddock, *supra* note 23, at 383 ("[N]eglect of Buchanan and Stubblebine's article *Externality* is as widespread among economists as among legal scholars, biologists, environmental scientists, or politicians."); Kieff, *supra* note 23, at 366; Todd J. Zywicki, *A Unanimity-Reinforcing Model of Efficiency in The Common Law: An Institutional Comparison of Common Law and Legislative Solutions to Large-Number Externality Problems*, 46 CASE W. RES. L. REV. 961, 988 n.91 (1996).

[72] *See* Buchanan & Stubblebine, *supra* note 71, at 380-81.

consumers could have obtained had the supplier's price not excluded them.[73]

Intellectual property law accepts deadweight loss in order to create incentives. Deadweight loss measures only losses from denied access. It does not measure the harm to incentives of denying exclusive rights. Externality theory and public goods theory recommend denying access only to the extent justified by the creation of incentives.[74] For intellectual property, an irrelevant externality is one that affects neither the supply of desirable information nor the benefits of access.[75] Relevant effects are those that increase information and the benefits derived from creative work.

This seemingly abstract theory applies directly to trademark policy. Relevant externalities in trademark law are those that affect trademark law's objectives. Trademark law is concerned with increasing the supply of information about the sources and characteristics of products and the benefits of access to that information. Exclusive trademark rights encourage trademark owners to invest in the signaling power of their marks. This signaling power is their goodwill. Signaling power is analogous to exclusive copyrights and patent rights. Protecting goodwill provides an incentive to increase the flow of accurate product and source information. Exclusive intellectual property rights increase the flow of information.

The ultimate objectives of protecting goodwill are to lower consumers' costs of searching for satisfactory products[76] and to increase

---

[73] *See* BARNES & STOUT, *supra* note 66, at 364-69.

[74] *See supra* Parts III.A and B.

[75] *See* Harrison, *supra* note 4, at 14 ("Put differently, as long as the creative effort is put forward, there is no need to incur costs to protect benefits beyond this minimum. These extra benefits . . . are irrelevant to the author's decision-making."). Such externalities are sometimes labeled merely "pecuniary" externalities as distinguished from "technological" externalities that affect the benefits derived from the use of resources. *See* Richard A. Epstein, *On Wal-Mart: Doing Good By Doing Nothing*, 39 CONN. L. REV. 1287, 1294 n.12 (2007) (citing Randall G. Holcombe & Russell S. Sobel, *Public Policy Toward Pecuniary Externalities*, 20 PUB. FIN. REV. 304, 304 (2001) ("Pecuniary externalities create third-part effects through changes in relative prices or asset prices. Unlike technological externalities, they do not misallocate resources and are necessary for the market to work efficiently.").

[76] *See, e.g.*, Ty Inc. v. Perryman, 306 F.3d 509, 510 (7th Cir. 2002):

> The fundamental purpose of a trademark is to reduce consumer search costs by providing a concise and unequivocal identifier of the particular source of particular goods. The consumer who knows at a glance whose brand he is being asked to buy knows whom to hold responsible if the brand disappoints and whose product to buy in the future if the brand pleases. This in turn gives producers an incentive to maintain high and uniform quality, since otherwise the investment in their trademark may be lost as customers turn away in disappointment from the brand. A successful brand, however, creates an incentive in unsuccessful competitors to pass off their inferior brand as the

competition.[77] This Article argues that externality theory and public goods theory apply to trademark law as they do to copyright and patent. If so, we would not protect goodwill for its own sake, but rather for the benefits investment in product and source information gives to society.

Given those objectives, we would discount arguments for internalization of uncompensated uses that increased consumers' search costs or decreased competition. We would not expand the scope of rights if the only effect is to give more compensation to trademark owners.[78] If internalizing an external benefit had no incentive effects or harmed competition, we would be protecting goodwill for its own sake. Such an externality is irrelevant and should be discounted in trademark policy.

Unauthorized uses of trademarks may create irrelevant or relevant effects, as judged by the purposes of trademark law. Uncompensated use of a mark by a competitor to describe his own goods – comparative advertising[79] – may diminish future revenue to the mark owner in two ways. First, permitting uncompensated comparative advertising may deprive the mark owner of revenue by diverting sales to a competitor's goods that better satisfies consumers' needs. Second, permitting uncompensated use denies licensing fees the owner could, hypothetically, obtain from the competitor. But such an arguments for internalization based on loss of revenue should be discounted.

Forbidding such use would neither generate additional incentives nor promote competition. The first effect, diversion of sales, is desirable. Comparative advertising reduces search costs. If a competitor better satisfies consumers' needs, the competition enhances consumer welfare. Internalizing the externality would be contrary to the ultimate goals of trademark law.

The second effect, denying licensing opportunities in this case, is unlikely to reduce trademarking activity. A mark owner is unlikely to license use of its mark to a competitor for use in comparative advertising disparaging the mark owner's product. While there may be licensing

---

> successful brand by adopting a confusingly similar trademark, in effect appropriating the goodwill created by the producer of the successful brand. The traditional and still central concern of trademark law is to provide remedies against this practice.

[77] *See* Park 'N Fly, Inc. v. Dollar Park & Fly, Inc., 469 U.S. 189, 193 (1985) ("Because trademarks desirably promote competition and the maintenance of product quality, Congress determined that 'a sound public policy requires that trademarks should receive nationally the greatest protection that can be given them.'" (quoting S. Rep. No. 1333, 79th Cong., 2d Sess., at 6 (1946)).

[78] One could, of course, offer moral arguments for increased compensation. As the discussion of the Supreme Court's opinion in *International News Service v. Associated Press*, 248 U.S. 215 (1918), indicates, that seems to fly in the face of the modern understanding of the roots of intellectual property. *See* Part V.A *infra* (discussing the rationale of *International News*); s*ee also* Breyer, *supra* note 21 (discussing and rejecting moral arguments for intellectual property protection).

[79] *See supra* text accompanying note 14.

opportunities, the mark owner is unlikely to seize any of them. Internalization would not increase licensing revenues.

On the other hand, unauthorized proprietary uses may have relevant effects. Classic passing off increases the costs of finding a particular trademark owner's goods. It misrepresents the qualities and characteristics of the goods, at least the source information, and interferes with competition on the merits. In classic passing off, the diversion of trade prevents consumers from satisfying their needs. And the diversion destroys the incentive to engage in trademarking activity. In both the comparative fair use and the passing off cases, we would want to consider whether the effect of internalization on creativity would, on balance, increase or decrease the supply of search-cost reducing and competition-enhancing information.

IV. EXTERNALITIES AND PUBLIC GOODS THEORY

The recent economic analysis of externalities in the intellectual property context replicates the implications of public goods theory. Public goods analysis is the traditional approach to copyright and patent law and an emerging approach to trademark law issues. Creative expressions and innovations have long been recognized as being non-rivalrous in their consumption and non-excludable in their supply.[80] These characteristics of public goods mean, respectively, that information once created can be simultaneously enjoyed by many people without interfering with the benefits each derives[81] and that it is difficult to exclude people from enjoying those benefits.[82]

A private individual's flower garden is often used as an example of a public good that produces positive externalities. Each neighbor can

---

[80] *See* Barnes, *supra* note 9.

[81] *See* RICHARD CORNES & TODD SANDLER, THE THEORY OF EXTERNALITIES, PUBLIC GOODS, AND CLUB GOODS 8 (2d ed. 1996); P.A. Samuelson, *Aspects of Public Expenditure Theories,* 40 REV. ECON. STATS. 332, 334 (1958) (discussing "public goods," "which s*imultaneously* enter into many persons' indifference curves"); P.A. Samuelson, *Diagrammatic Exposition of a Theory of Public Expenditure*, 37 REV. ECON. & STATS. 350, 350 (1955) (stating that a "public consumption good . . . differs from a private consumption good in that each man's consumption of it, X^1_2 and X^2_2 respectively, is related to the total X_2 by a condition of *equality* rather than of summation"); P.A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STATS. 387, 387 (1954) (defining "collective consumption goods" as those "which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good").

[82] *See* GIFFORD & SANTONI, *supra* note 5, at 32 ("A characteristic of *some* public goods (and some private goods) is that, once the good is produced, it is extremely costly to prevent individuals from consuming the good."). Economists sometimes classify public goods that are excludable as "club goods" and define public goods as those possessing characteristics of both rivalry and non-excludability. *See, e.g.*, CORNES & SANDLER, *supra* note 81, at 23.

enjoy the flowers without diminishing the pleasures others obtain – "consumption by one person does not deplete the view or beauty available for others to consume."[83] Accordingly, there is no cost to letting passers-by or neighboring homeowners gain external benefits.

Describing a "new economics of trademark" in 2006, Professor Barnes noted the following implications of public goods theory for trademark law:

> Non-rivalry creates a static/dynamic dilemma. Charging non-rivalrous users of a public good creates a deadweight loss by excluding some users, but not charging them diminishes suppliers' incentives to supply, potentially creating a deadweight loss due to underprovision of the good. By permitting unrestricted, free referential and customary use, trademark law increases the non-rivalrous use of search information, reducing but not eliminating the deadweight loss associated with static inefficiency.
>
> Non-excludability diminishes suppliers' incentives and obscures users' demand for the good. Trademark law does nothing to reveal the value many referential and customary users place on search information so does little to ensure that the optimal amount of search information is provided.[84]

This summary reveals two policy implications of characterizing information as a public good. The first is expressed as a long-run or dynamic allocative efficiency concern[85] that there will be insufficient market incentives to encourage the production of creative works and innovations. If consumers cannot be excluded because of the high cost of doing so, creators and innovators may not get enough incentive to produce and there will be no market signal regarding the optimal quantity to produce. This parallels the first two potential market failures one can derive from externalities theory – failure of incentives and failure to reveal demand.[86] These failures potentially arise if there is incomplete internalization of positive externalities. These failures, taken alone, suggest a policy of expanding trademark rights.

---

[83] Frischmann, *supra* note 23, at 966.

[84] Barnes, *supra* note 9, at 65.

[85] Frischmann, *supra* note 23, at 947 (comparing static and dynamic efficiency and concluding that "[t]aken together, these two perspectives — static and dynamic efficiency – yield a complicated economic puzzle in terms of maximizing social welfare. As a policy matter, it may be necessary to strike a balance between opening access to reap static efficiency gains and restricting access to reap dynamic efficiency gains.").

[86] *See supra* text accompanying notes 17-22.

Expanding trademark rights, however, potentially gives rise to another potential market failure, which may be characterized as a short-run or static allocative efficiency concern.[87] If creators and innovators can charge those who benefit, some who could enjoy the benefits at no cost will not have access. Non-rivalry means that, once produced, information can be simultaneously and costlessly consumed by many. This potential market failure, taken alone, suggests a policy of decreased propertization of trademarks. The dynamic and static concerns conflict. Obviously, a balancing of interests is required.

Copyright and patent policy recognize that the first market failure, failure of incentives, cannot be met simply by full internalization because that interferes with the static allocative efficiency concern, free access to avoid deadweight loss. The result is a relatively short term for exclusive patent rights, after which access is free, and restrictions on the scope of copyright protection. These term and use restrictions attempt to balance the dynamic and static concerns.

Because trademarks share the characteristics of providing external benefits and may be characterized as mixed public goods, they share the same potential for failures in the market for trademarking activity. Mixed public goods are ones with both rivalrous and non-rivalrous uses[88] – competing proprietary uses are rivalrous and referential uses are generally non-rivalrous. A comparable policy analysis, with a balancing of dynamic and static efficiency, is therefore appropriate whenever we consider a non-rivalrous referential use. The challenge is to find the scope of rights that simultaneously encourages creativity and permits access – the optimal balance between exclusive rights and public access.

This is precisely the conclusion of the analysis of copyright and patent based on spillovers and externalities. This parallel between the analysis of externalities and of public goods should come as no surprise to economists; public goods create external benefits.[89] That is not to say that the "spillovers" or "externalities" approach to intellectual property issues is not useful. It is often extremely valuable to adopt a fresh perspective on issues, as the recent work by Harrison, Frischmann, and Lemley illustrates. Nevertheless, the bottom line from both approaches is that there may be optimal provision of public goods without additional incentives and not all external benefits should be internalized.[90] Professor F.H.

---

[87] *See id.*

[88] *See* Barnes, *supra* note 9, at 45-47 (arguing that trademarks are mixed public goods).

[89] GIFFORD & SANTONI, *supra* note 5, at 37.

[90] Glynn S. Lunney, *Trademark Monopolies*, 48 EMORY L.J. 367 (1999), comes to the same conclusion from a micro-economic/industrial organization perspective. Lunney assumes there is free-riding (external benefits) and considers whether competitive and monopolistic markets will supply an optimal level of output of goods subject to free-riding. From the perspective of market structure, particularly the comparative structures of markets throughout the economy, "the externality created by such conflicting uses [of

Buckley summarizes the policy conclusion in both externality and public goods terms: "Where my actions confer positive externalities, it does not follow that I will undersupply the public goods unless others chip in. . . . What matters is whether, at the margin, public goods are undersupplied and public bads oversupplied, and not whether there are third party effects."[91]

Although it has been recognized that trademarking activity creates external benefits,[92] trademark policy is not customarily evaluated from either an externalities or public goods perspective. Until recently, scholars had denied that trademarks shared the public goods characteristics of copyrighted expressions and patented innovations.[93] Scholars have similarly not analyzed the scope of trademark rights from an externalities perspective.

External benefits in patent and copyright are analogous to external benefits in trademark. Patent externalities include benefits derived by competitors who make money from making, using, or selling an invention after the patent has expired, people who benefit from the more vibrant economy innovation supports, industries in unrelated fields who benefit from the ideas revealed with the innovation and others who learn from the disclosure, and consumers whose benefit from new products exceeds the prices they pay.[94] Copyright externalities include benefits derived by those who exploit a copyrighted work once it has entered the public domain, creators who exploit unprotected elements of a work such as ideas,

---

trademarks] justifies government intervention only if disproportionate to the externalities associated with other productive activities and only if so large as to eliminate a sufficient incentive to create popular marks." *Id.* at 464. He dismisses the need to expand the scope of trademark rights concluding that free riders are both desirable and necessary for allocative efficiency. *See id.* at 442. His explanation is based on examination of the effect of free-riding on the allocation of resources in competitive markets, *id.* at 446; the necessity for correcting market failures in a competitive economy, *id.* at 447; the salutary effect of free-riding in monopolistic markets, *id.* at 451; and the extent of the advantages the supplier of a good susceptible to free-riding gets from being the first one in the market to supply that good, *id.* at 452.

[91] F.H. Buckley, *Perfectionism*, 13 SUP. CT. ECON. REV. 133, 140-41 (2005).

[92] For recent examples, see, for example, Manavinder S. Bains, *The Search Engine Economy's Achilles Heel? Addressing Online Parallel Imports Resulting from Keyword and Metatag Misuse*, 2006 STAN. TECH. L. REV. 6, 98 (2006) (listing minimization of search costs, facilitation of economies of scale, and producer motivation to maintain quality standards as positive externalities of trademark law); Matthew Ellman, *Specificity Revisited: The Role of Cross-Investments*, 22 J. L. ECON. & ORG. 234, 250 (2006) (recognizing the external benefits trademark licenses create for other licensees when they invest in the reputation of the trademark); Clarisa Long, *Dilution*, 10 COLUM. L. REV. 1029, 1059, 1061 (2006) (characterizing dilution law as a congressional attempt to internalize to owners of famous marks the benefits others derive from that fame).

[93] *See* Barnes, *supra* note 9 (arguing that trademarks are mixed public goods and that the optimal provision of trademarks faces the same static/dynamic dilemma as the provision of copyrighted works and patented innovations).

[94] *See* Frischmann & Lemley, *supra* note 4, at 260-62.

designers of products that allow consumers to enjoy copyrighted works like DVD players and iPods, consumers who benefit from the works they consume by being educated and socialized[95] (to the extent this benefit is not captured in the price they pay), and those who engage in "fair use" of the work during its period of protection.[96] These benefits are typically not internalized.

Part II of this Article identified the positive externalities associated with trademarking activity. Those most obviously benefiting from a mark owners' investment include competitors who pass off their goods as those of the owner by using in a proprietary way a mark confusingly similar to the owner's mark and consumers who use the owner's mark referentially in searching for goods that satisfy their needs and buying those goods. Some of these benefits are internalized, through infringement actions resulting in payment of damages in the first case and through payment of a higher price for the product in the second. Other referential users do not pay: consumers who rely on the goodwill of the owner's mark (the signaling power, the informational content) to reject the good; suppliers of substitute or complementary goods who engage in comparative advertising; and social commentators and artists whose expression is enriched by reference to the owner's mark and those who benefit from that expression. The question of the scope of trademark rights is a question of which external benefits should be internalized.

V. EXTERNALITIES, PUBLIC GOODS, AND MISAPPROPRIATION DOCTRINE

This Part describes the relationship between the externality and public goods theories and the Supreme Court's misappropriation doctrine. The discussion of misappropriation doctrine in Part V.A demonstrates how the Supreme Court intuited the implications of externality and public goods theory and arrived at a remedy consistent with those theories. Part V.B recasts the operational rules described in Part III in a misappropriation framework. These rules illustrate that the Supreme Court misappropriation doctrine reflects the same underlying balancing process derived from both externalities and public goods theory.

A. THE MISAPPROPRIATION DOCTRINE.

Modern misappropriation doctrine is derived from *International News Service v. Associated Press*.[97] Compensation for external benefits was the focus of the court's opinion. In that case, Associated Press (AP) created internalized and external benefits by collecting news from England during World War I. It received payments from newspaper publishers to

[95] *Id.* at 285.

[96] *Id.* at 288.

[97] 248 U.S. 215 (1918).

whom it disseminated the news,[98] so some of the benefits from its efforts were internalized. This compensation provided some incentive to engage in the production of public goods, information to readers of the papers. These benefits were internalized because the readers paid the publishers for their copies of the papers.

AP also produced external benefits to free riders who benefited from its production of a public good. Among those who free ride on the publication of newspapers are those who learn the news from those who do pay for and read the newspapers. Democratic society also presumably benefits from a more informed citizenry. Free access to news is desirable.

An additional beneficiary of AP's investment was its competitor, International News Service (INS). INS obtained the war news collected by AP before it was published by the newspapers through a variety of devices: bribing newspaper employees, inducing AP's clients/members to send INS the news in violation of their agreements with AP, and copying news from bulletin boards and early editions of AP's client/member newspapers.[99] INS disseminated news thus acquired to its own paying customers without any payment to AP.[100] Because distribution of news and publication takes time, INS's customers had the news available for its readers simultaneously with the service of competing AP newspapers.[101] AP complained about INS's free-riding through these various devices.

For the Supreme Court, the question turned on whether INS's conduct was unfair competition.[102] In externality terms, it was a question of whether the benefits from the particular use of the public good produced by AP should be internalized. It did not depend on whether there were property rights, but rather on the functioning of the business of making news known to the world.[103] "The question of what is unfair competition in business must be determined with particular reference to the character and circumstances of the business."[104]

The Court focused on the external benefits created by AP and exploited by INS. The Supreme Court stated that "he who has fairly paid the price should have the beneficial use of the property."[105] But the Court was unconcerned with internalizing all of the positive externalities created by the newspapers' publication of the news to the public. For instance, "[t]he right of the purchaser of a single newspaper to spread knowledge of

---

[98] *Id.* at 229.

[99] *Id.* at 231.

[100] *Id.* at 232.

[101] *Id.* at 238.

[102] *Id.* at 235.

[103] *Id.*

[104] *Id.* at 236.

[105] *Id.* at 240.

its contents gratuitously, for any legitimate purpose not unreasonably interfering with complainant's right to make merchandise of it, may be admitted."[106] But what are the limits to free use? Which uses by others should provide external benefits and which should be internalized?

The Court rejected INS's argument that AP abandoned the news to public use when it disseminated the news to its members. Recognizing this argument would "render publication profitless, or so little profitable as in effect to cut off the service by rendering the cost prohibitive in comparison with the return."[107] In other words, while free access might be desirable, access must not be so free as to deprive the producer of public goods of sufficient incentive to produce the goods. INS's conduct "amounts to an unauthorized interference with the normal operation of complainant's legitimate business *precisely at the point where the profit is to be reaped*, in order to divert a *material* portion of the profit from those who have earned it to those who have not."[108] Accordingly, the Court declined to modify the district court's injunction prohibiting this appropriation of the news "until its commercial value as news to the complainant and all of its members has passed away."[109]

It is instructive to note what the injunction prohibited and why. It did not attempt to internalize all of the external benefits associated with AP's investment. It did not prohibit competitors' use of the news content after its immediate commercial value as hot news had passed. It even approved of the benefit rival news gathers obtained from the leads ("tips") provided by others new gathers. It only prohibited free-riding that would prevent newsgathering by interfering "precisely at the point where profit is to be reaped" by diverting a "material" portion of the profit from those who have earned it to those who have not.[110]

The concern with profitability of an enterprise that produces external benefits is no surprise to analysts familiar with the economics of externalities and public goods. The tradeoff is between dynamic and static efficiency. In *International News Service*, this meant balancing the need to encourage investment in creative activity by providing enough compensation to ensure that the news was gathered and disseminated with the need to encourage access to the fruit of the creative activity by widespread dissemination of news. The external benefits of having an informed populace could not conceivably be internalized to AP. The question was where to draw the line.

The same question arises in trademark law. Expansions in trademark protection based on goodwill are focused only on compensation

---

[106] *Id.* at 239.

[107] *Id.* at 241.

[108] *Id.* at 240 (emphasis added).

[109] *Id.* at 245.

[110] *Id.* at 242-45.

to the creator – dynamic efficiency. How much compensation is appropriate given the interest in static efficiency?

B. OPERATIONAL RULES REVISITED.

Combining the general theories of externalities and public goods and the lessons of *International News Service* sheds light on modern "trademark puzzles."[111] Both economic theory and Supreme Court reasoning support a five-step analytical approach to determining the scope of intellectual property rights.

1. Did *A* create valuable information? This is the basic intellectual property question of whether *A* has produced copyrightable or patentable subject matter or used a mark that qualifies for protection.

2. Has another person benefited from use of that information without compensation? This is the basic question of whether another person is a free rider. Subsequent questions determine whether this appropriation of another's creation is properly characterized as *misappropriation*.

3. Effect on Incentives. Would permitting only compensated use by this type of user motivate *A* to supply more information? This addresses the dynamic efficiency concern from public goods theory. Externality theory starts with the recognition that some internalization is necessary to provide incentive to invest in creative activity. In trademark terms, this means a social benefit in terms of more and better information to reduce search costs and increase competition.

Public goods theory focuses on whether the type of use is one that interferes with the benefits derived by others. Prohibiting some uses will create no greater incentive for creative activity. The supply-side perspective of externalities theory focuses on whether increased internalization will produce the optimal level of investment in production of information. The demand-side perspective considers the ability of the creator of information to recognize the full extent of demand for that information.

4. Benefits of Free Access. Would permitting only compensated uses by this type of user interfere with other values? The relevant value for trademark law is the production of accurate information that reduces search costs and increases competition and consumer satisfaction with the goods they purchase. Like the information fixed in tangible means of expression and disclosed in patent applications, the source and product characteristic information associated with a trademark can be consumed by some users non-rivalrously and thus has the characteristics of a public good.

---

[111] *See* Robert C. Bone, *Enforcement Costs and Trademark Puzzles*, 90 VA. L. REV. 2099 (2004) (listing policy issues currently facing trademark law and offering a model based on the cost of enforcing trademark rights to explain the structure of the law).

For all of intellectual property, free access means avoiding the costs of protecting exclusive rights, which are saved if free access is permitted. In the context of expanding trademark rights, these might primarily be avoiding the cost of litigation. When the incentive effects of internalization of benefits are slight, it makes little sense for society to incur the costs of litigation.

5. Net Benefits from Internalization. Would the likely value derived from an increase in the supply of information justify the interference with other values? Public goods theory highlights the conflict between the need to provide incentives, dynamic efficiency through internalization of externalities, and static efficiency through maximizing access to those whose consumption is non-rivalrous by permitting uncompensated use. Externalities theory emphasizes the need to internalize only sufficient benefits to optimize investment in the production of information by protecting works only when doing so creates more social benefits than costs and incurring no greater social cost than necessary to provide incentives to the creator. A balancing of considerations is inevitable. The optimal scope of trademark rights can be analyzed by applying these rules.[112]

VI. THE SCOPE OF TRADEMARK RIGHTS

The optimal scope of trademark rights depends on the incentive effects of internalizing external benefits and the benefits of permitting free-riding. Part VI.A applies the balancing test described in Part V.B to a

---

[112] Commentators and courts frequently overlook this balancing. *See, e.g.*, J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 10.51 (4th ed. 2007):

> A synthesis of the majority opinion in *INS v. AP* and the cases that have followed that decision result in the conclusion that the following three elements are necessary to plead and prove a case of misappropriation:
>
> > (1) Plaintiff has made a substantial investment of time, effort and money into creating the thing misappropriated such the court can characterize that "thing" as a kind of property right.
> >
> > (2) Defendant has appropriated the 'thing at little or no cost, such that the court can characterize defendant's actions as "reaping where it has not sown."
> >
> > (3) Defendant has injured plaintiff by the misappropriation.

Some courts identify the need for free-riding that creates a special competitive advantage, though they do not specifically identify this as a balancing process. *See* Alcatel USA, Inc. v. DGI Technologies, Inc., 166 F.3d 772, 788 (5th Cir. 1999) (listing the elements as "(i) the creation by plaintiff of a product through extensive time, labor, skill and money; (ii) the use of that product by defendant in competition with plaintiff, thereby giving the defendant a special competitive advantage because he was burdened with little or none of the expense incurred by plaintiff in the creation of the product; and (iii) commercial damage to plaintiff").

classic trademark infringement case to illustrate the logic behind granting exclusive rights to prevent competing proprietary uses. Part VI.B applies the balancing test to the case of Internet initial interest confusion to illustrate the considerations involved in deciding whether trademark law should enjoin this use. Part VI.C extends the analysis briefly to sponsorship and post-sale confusion. Among these areas on the edge of trademark law, post-sale confusion presents the strongest case for extending exclusive rights and Internet initial interest confusion presents the weakest.

A. A CLASSIC TRADEMARK INFRINGEMENT CASE: COMPETING PROPRIETARY USE

Application of the operational rules derived from externality and public goods theory and the misappropriation doctrine is relatively straightforward in a typical infringement case. The classic case of trademark infringement involves a competing supplier of goods using another's mark to mislead consumers about the source of its goods. The first two analytical steps, which demonstrate free-riding, are easily managed. The owner has created information about the source and characteristics of its products that is valuable to others, both competitors and consumers. And the competing supplier has used that mark without compensation to produce external benefits to itself. The remaining three steps consider whether this competing proprietary use is appropriation or *misappropriation*.

Effect on Incentives. Competing proprietary use discourages investment in trademarking activity. Permitting only compensated use enables suppliers of goods to ensure that only suppliers of goods conforming to the owner's standards use the mark. This enables consumers to rely on the mark owner's reputation (good or bad) for supplying goods of consistent quality (high or low) and other characteristics. If competing suppliers use the same mark proprietarily, there is no assurance that the source or product information signaled by the mark is accurate. Unable to create reliable signals, the mark owner's incentive to invest in trademarking activities would be diminished. Even would-be purchasers would be unwilling to compensate the trademark owner for that activity. The infringer interferes with the mark owner's investment exactly at the point where there is money to be made from the trademarking activity.

Benefits of Free Access. Free access may enhance competitors' revenues but only by injuring mark owners, consumers, and competition. Permitting only compensated use interferes with competitors' ability to divert consumers from the trademark owner's goods to its own – in short, interferes with the competitor's ability to compete. Consumers benefit from the presence of more competitors if greater competition enables consumers to satisfy their needs better by (a) lowering prices, (b)

increasing variety of product characteristics and qualities on the market, or (c) otherwise making it easier for consumers to locate and obtain goods that satisfy their needs for price, quality, and other characteristics.

Competing proprietary uses of a trademark may fare well by the first desideratum. The infringing competitor can offer a lower price because it does not have to bear the costs of trademarking activity. Allowing uncompensated competitive proprietary use may enable competing sellers to sell goods with characteristics different from those of the mark owner's goods. Those competing goods might meet consumers' needs better. Free-riding on another's mark may make entry into the market easier. There might, then, be some benefits to free access by competing proprietary users.

These benefits, however, are likely to be illusory. A greater variety of goods is desirable only if consumers know what they are getting. Confusing signals increase search costs. Because an infringement action is based on likelihood of confusion at the point of sale, consumers are likely to believe they are getting the mark owner's goods. The infringer's pro-competitive argument is that they are deceiving consumers to benefit the consumers. This would be a novel view of the competitive process. The entry argument is also weak. One would expect a producer of more pleasing goods to be more eager to differentiate itself by its own trademarking activity. Of the purported benefits of free access by competing proprietary users, then, we are left only with lower prices that likely result in consumers unwittingly buying less satisfactory goods. It is the essence of competition on the merits that consumers know the price/quality dimensions of competing products.[113]

Net Benefits from Internalization. Passing off by using another's trademark is not competition on the merits. This competing proprietary use makes it more difficult for consumers to locate and obtain goods that satisfy their needs. With little if any pro-competitive benefit sacrificed by permitting only compensated competing proprietary use, the overwhelming advantages of the increased supply of trademarking activity are apparent, even given the costs of litigation necessary to enforce exclusive rights.

B. INTERNET INITIAL INTEREST CONFUSION

Scholarly discussion of extending exclusive trademark rights by prohibiting uses beyond the classic passing off context has been labeled the "propertization" debate.[114] The propertization label has particular

---

[113] *See* E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 10 (1998) (stating that for a market to be perfectly competitive "producers and consumers [must] have complete information of all relevant market factors").

[114] *See, e.g.*, Lemley, *supra* note 23, at 1033, 1035 n.8; Michael Pulos, *A Semiotic Solution to the Propertization Problem of Trademark*, 53 UCLA L. REV. 833, 833 (2006).

resonance for externality theory. Externality theory is based on the idea that internalizing external harms and benefits gives proper incentives for those who develop property and invest in the creation of new property. Recent extensions of externality theory to intellectual property are concerned with the extent of internalization, with the extent of property rights.

One of the most divisive issues in the propertization debate involves initial interest confusion.[115] As in the classic case of passing off using a trademark, initial interest confusion cases involve a creator of intellectual property and a free rider. The creator is a trademark owner who has invested to develop a well-known, even famous, mark. The free rider is a competitor who has benefited without compensating the owner – a free rider who reaps where he has not sown, the recipient of an external benefit. But extending exclusive rights in the purest examples of these free-riding cases would not not protect buyers from source confusion, increase competition, directly affect incentives to provide information, or increase the amount of desirable trademarking activity. Extending exclusive rights would simply prevent free-riding. Comparative advertising has the characteristics of these free-riding cases.[116]

Initial interest confusion, sponsorship, and post-sale confusion cases all have these characteristics to some extent: lower likelihood of confusion, increased competition on the merits, less direct effect on incentives, and no diminution of trademarking activity. The following discussion focuses on initial interest confusion arising from Internet search use of trademarks to illustrate the analysis that flows from externalities theory, public goods theory, and misappropriation doctrine. Part VI.1 discusses a classic Internet initial interest confusion case, while Part VI.2 discusses variations on the classic case that may affect the balancing of benefits and costs of extending exclusive rights. Part VI.3 briefly considers how the balancing process works in sponsorship and post-sale confusion cases.

1. A Classic Internet Initial Interest Confusion Case.

Among the scholars writing recently about treating trademarks as property are Stacy L. Dogan & Mark A. Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUS. L. REV. 777, 783, 788, 800-01 (2004); Jennifer E. Rothman, *Initial Interest Confusion: Standing at the Crossroads of Trademark Law*, 27 CARDOZO L. REV. 105, 112, 130 (2005); and Uli Widmaier, *Use, Liability, & the Structure of Trademark Law*, 33 HOFSTRA L. REV. 603, 606, 610, 616-17 (2004). For a list of earlier articles, see Vincent Chiappetta, *Trademarks: More Than Meets the Eye*, 2003 U. ILL. J.L. TECH. & POL'Y 35, 35 n.1.

[115] *See, e.g.*, Lisa M. Sharrock, *Realigning the Initial Interest Confusion Doctrine with the Lanham Act*, 25 WHITTIER L. REV. 53, 60-73 (2003) (discussing the concept of trademarks as property and the split among federal circuit courts on the treatment of trademarks in the initial interest confusion context).

[116] *See supra* text accompanying note 78.

Initial interest confusion results when a party's conduct temporarily confuses a computer user about who is the source of a product or service marketed on the Internet.[117] Initial interest confusion is distinguished from the typical point-of-sale confusion seen in traditional trademark/passing off cases because the confusion is dispelled before the consumer engages in a commercial transaction with the party. Because the confusion is dispelled, the consumer is not deceived about who is supplying the good or service he or she purchases.

Internet initial interest confusion typically arises from an advertiser of goods or services paying an Internet search engine operator to display its advertising or a link to its website in response to a computer user's search inquiry. Better Metal, L.L.C. is a seller of parts used in the construction of wireless telecommunications towers.[118] It paid Yahoo, Inc., an Internet search engine operator, to list its website as a sponsored link when a computer user searched for some combination of the keywords "1," "pro," and "site."[119] Site Pro-1, Inc. is a direct competitor of Better Metal.[120] Sponsored links appear at the top or on the side of the search results pages in areas clearly marked "Sponsored Links." When the computer user clicked on the Better Metal link, he or she was taken to the Better Metal website, rather than to the Site Pro-1 website, which was not listed as a sponsored link, but was shown elsewhere on the search results page.

This case is described as "initial interest confusion" because if the consumer is confused about who is sponsoring the pop-up ad or website link, that confusion is dispelled before any purchase is made. Once the computer user clicks on the link, it is obvious that the website to which he or she is sent is Better Metal. If the consumer is likely to believe that the website is Site Pro-1, the confusion is not dispelled and that is regular confusion.

All variations of Internet initial interest confusion cases involve an investment of resources in trademarking activity by the trademark owner and free-riding by the alleged infringer. The policy analysis then depends on the balancing of the benefits from exclusive rights and free access in this context.

Effect on Incentives. The potential dynamic inefficiency associated with an advertiser's free access to another's mark is insufficient incentive

---

[117] Playboy Enters., Inc. v. Netscape Commc'ns. Corp., 354 F.3d 1020, 1025 (9th Cir. 2004) ("Initial interest confusion is customer confusion that creates initial interest in a competitor's product. Although dispelled before an actual sale occurs, initial interest confusion impermissibly capitalizes on the goodwill associated with a mark and is therefore actionable trademark infringement.").

[118] Site Pro-1, Inc. v. Better Metal, L.L.C., No. 06-CV-6508 (ILG) (RER), 2007 WL 1385730, at *1, (E.D.N.Y. May 9, 2007).

[119] *Id.*

[120] *Id.*

for trademarking activity by owners of marks. This potential inefficiency is addressed by enjoining such uncompensated use. While it is difficult to know whether there is insufficient incentive, it is possible to analyze whether internalization will encourage more creativity.

Beneficial trademarking activity could result from enjoining Internet initial interest confusion in two ways. First, the trademark owner might obtain additional revenue by licensing its rivals or the search engine provider and investing that revenue in producing valuable source or product information. This beneficial effect is unlikely because trademark owners would be reluctant to aid their competitors by licensing their marks for this type of use.

Second, the grant of exclusive right might prevent mark owners' loss of revenue to these competitors. The ads and links are designed to inform customers of market alternatives and divert sales to the advertisers. By prohibiting this information, trademark owners can maintain their revenue, which would allow them to continue their present level of trademarking activity. Or, by refusing to license, the owner might raise the rival's costs of doing business by forcing the rival to find more costly or less effective ways of attracting consumers. Raising a rival's costs is a widely recognized way of obtaining competitive advantage.[121] This suggests a beneficial effect on incentives from expanding exclusive rights.

But it would be contrary to trademark policy to increase incentives by diminishing competition. Competition might be increased by Internet advertising that alerts consumers to market substitutes. Raising rivals' costs is generally considered anticompetitive.[122] Competition on the merits improves consumer welfare by better providing competing goods consumers prefer. As long as any confusion is dispelled by the time consumers buy goods or services, as initial interest confusion assumes, consumers may be presumed to have found the alternative goods at least as desirable as the mark owners' goods. The loss of revenue to the trademark owner is offset by an increase in revenue by the advertiser if consumers are better able to find desirable goods. The beneficial effect of expanding trademark rights to cover Internet initial interest confusion therefore seems illusory.

Benefits of Free Access. The benefits from permitting this use of trademarks as keywords are found in decreased consumer search costs and increased competition. This conduct may both increase and decrease search costs. In the Better Metal context, search costs are increased if a computer user desiring Site Pro-1's website must scroll down past Better Metal's sponsored ad or look around more carefully on the screen results page to find Site Pro-1's website. Because reducing consumers' search

---

[121] *See* G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals Costs to Achieve Power over Price*, 96 YALE L.J. 209, 228-229 (1986).

[122] *See id.*

costs is one of the goals of trademark law, preventing this increase in search costs is a benefit of recognizing exclusive rights.

Search costs might, however, be reduced for consumers who are searching not just for Site Pro-1's product but for telecommunication tower parts that best fit their requirements. Better Metal's conduct informs consumers about a market substitute to Site Pro-1, about whom they apparently are already aware, given their search strategy. Competition would also be enhanced by the existence of a market substitute that better satisfies consumers. The natural response to such competition would be to try harder to meet consumers' demand by adjusting quality, variety, or price.

Net Benefits from Internalization. The increase in search costs from Internet initial interest confusion seems small. It only applies to computer users trying to find a particular supplier, Site Pro-1 in this example. They must look more carefully on search results page for the official website. Or they might open a link or click on an advertisement by mistake. As long as the result is clearly not Site Pro-1 (as long as there is no confusion at the point of sale), they need merely to click back to the search results page.

Any increase in search costs is offset by the benefits of being able to find potentially superior competitive market substitutes. For computer users looking for a particular supplier, the addition to search costs is small. Sophisticated computer users are accustomed to skipping right over any sponsored links that are inapplicable. The increase in search cost argument does not apply at all to consumers who are trying to find a supplier whose goods or services best fit their needs.

As long as consumers know with whom they are dealing when they are reviewing a particular supplier's website, there seem to be only competitive advantages from permitting this conduct. Any customers lost to the mark owner will be those equally or better satisfied by the competitor's product or those too lazy to compare products. It does not seem desirable to protect the trademark owner's share of the lazy consumers market given the potential improvement in competition.

Lastly, the traditional justification for the grant of exclusive rights – protecting revenue to provide incentives for creating activity – does not apply here. The low likelihood of licensing a mark to a competitor for this purpose means there would not likely be increased revenue to devote to trademarking activity. Any decline in revenue due to increased competition on the merits is merely a transfer of wealth that can only be prevented by obscuring market alternatives. Intellectual property protection is not given for its own sake but rather to encourage the production of useful information.

2. Variations on the Classic Case.

There are variations in the facts in Internet initial interest confusion cases that might affect the policy balance. They would involve conduct

that increased search costs, or decreased competition on the merits. Factually, the content of results returned by the search engine is most relevant. These factual differences might produce different legal results and have different policy implications.[123]

Several cases illustrate the policy implications of alternative factual contexts. Hamzik owns the registered trademark "dating rings" for rings and other jewelry.[124] Zales purchased the key word "dating rings" from Internet search engines that displayed the result "Dating Rings – Zales." By contrast, the Site Pro-1 mark never appeared in conjunction with the Better Metal names. The use in conjunction with the Zales mark is more likely to cause confusion if it appears to the computer user that Zales is the source of rings with the mark "Dating Rings." Any confusion would increase the search cost of consumers seeking rings with the source and quality properly indicated by the mark unless that confusion were dispelled by its context.

Similarly, the longer it takes for the consumer to clarify the confusion, the greater is the increase in search costs. In *Brookfield Communications*, the Ninth Circuit offered an analogy to the competing enterprise misleading consumers in a way that would more dramatically increase search costs and decrease competition on the merits:

> Suppose West Coast's competitor (let's call it "Blockbuster") puts up a billboard on a highway reading-"West Coast Video: 2 miles ahead at Exit 7"-where West Coast is really located at Exit 8 but Blockbuster is located at Exit 7. Customers looking for West Coast's store will pull off at Exit 7 and drive around looking for it. Unable to locate West Coast, but seeing the Blockbuster store right by the highway entrance, they may simply rent there. Even consumers who prefer West Coast may find it not worth the trouble to continue searching for West Coast since there is a Blockbuster right there.[125]

---

[123] There are also different ways in which search engines receive instructions. *Better Metal* illustrates the purchase of another's mark for use as a keyword. In a second example, TheMSLonline.com used links and text on its website that was hidden from viewers by appearing as white on white. Edina Realty, Inc. v. The MSLonline.com, 80 U.S.P.Q. 1039, 2006 WL 737064, at *2 (D. Minn. 2006) (denying defendant's motion for summary judgment on the grounds that this did not present a prima facie case of trademark infringement). The links and texts included the phrase "Edina Realty," the mark of the owner bringing suit. They caused TheMSLonline.com website to appear higher on the list of results returned by the search for Edina Realty. In neither case was the mark visible to the computer user except insofar as the user had entered it in the search panel. These factual variations do not affect the analysis.

[124] Hamzik v. Zale Corp., N.D.N.Y., No. 3:06-cv-1300 (May 19, 2007).

[125] Brookfield Commc'ns, Inc. v. Westcoast Entm't Corp., 174 F.3d 1036, 1064 (9th Cir. 1999). The court concluded:

The reason the Blockbuster example is compelling is that it raises the costs of those consumers who were lured to the competitor. Imagine seeing a sign raising one's hope that a Starbucks coffee can be found by exiting the turnpike and being faced with costs of either getting back on the highway or drinking a less satisfying coffee. This is not competition on the merits.

Some likelihood of confusion might not be enough to justify enjoining the use. As the Supreme Court instructed in a 2004 trademark fair use case, some confusion is tolerable in fair use cases where commercially justified to support the advantages of increased competition.[126] It is, therefore, consistent with the law to consider a balance between competing policy objectives.

Thus, the more likely the consumer is to be confused about the source of goods while shopping or purchasing, the more likely the conduct interferes with the competition on the merits. Lencore Acoustics Corporation, a manufacturer of sound masking-equipment,[127] used a rival's SCAMP trademark in its metatags[128] to attract consumers to its website.[129] The website offered equipment with names "LM4" and "LM6"

> Customers are not confused in the narrow sense: they are fully aware that they are purchasing from Blockbuster and they have no reason to believe that Blockbuster is related to, or in any way sponsored by, West Coast. Nevertheless, the fact that there is only initial consumer confusion does not alter the fact that Blockbuster would be misappropriating West Coast's acquired goodwill.

Id.

[126] KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc., 543 U.S. 111, 122 (2004) (holding that the defendant claiming a fair use defense in a trademark infringement case need not prove the total absence of confusion). The Court opened the door to balancing the potential for confusion with other concerns:

> [T]he proceedings in this case so far raise no occasion to evaluate some other concerns that courts might pick as relevant, quite apart from attention to confusion. The Restatement raises possibilities like commercial justification and the strength of the plaintiff's mark. As to them, it is enough to say here that the door is not closed.

Id. at 123 (citation omitted).

[127] Sound masking is a process by which background sound levels are controlled so as to render ambient speech unintelligible to persons beyond the range of face-to-face conversation. The process is particularly useful in reducing the perceived noise level of open office space. 777388 Ontario Ltd. v. Lencore Acoustics Corp., 105 F.Supp.2d 56, 58 (E.D.N.Y. 2000).

[128] A "metatag" is a sequence of computer code written in Hypertext Markup Language. As the Ninth Circuit described them, metatags may generally be distinguished between "description" and "keyword" metatags. The description metatags are intended to describe the web site; the keyword metatags, at least in theory, contain keywords relating to the contents of the web site. The more often a term appears in the metatags and in the text of the web page, the more likely it is that the web page will be 'hit' in a search for that keyword and the higher on the list of 'hits' the web page will appear. *Brookfield*, 174 F.3d at 1045.

[129] *Ontario*, 105 F.Supp.2d at 59.

similar to the plaintiff's marks, "PLM4" and "PLM6."[130] The case is appealing as an example of infringement because the website itself contains information likely to cause point of sale confusion, which raises search costs and is not competition on the merits.

A fact that is irrelevant to the balancing process is whether the advertiser paid the search engine provider for use of a specific trademark. Google sold a competing online advertiser the use of the trademark "American Blind," a trademark owned by American Blind and Wallpaper Factory, Inc., for use in generating a sponsored link.[131] The court found that the sale of use of the mark by a search engine provider was a sufficient use to support a trademark infringement claim. However, the federal courts differ on this conclusion.[132] While Google's sale is certainly free-riding in the sense of being an uncompensated use of another's trademark, the mere existence of external benefits does not mean that they should be internalized. Static efficiency (access) as well as dynamic efficiency (incentive) concerns should both be addressed.

C. SPONSORSHIP AND POST-SALE CONFUSION

The wide variety of possible proprietary and referential uses of trademarks necessitates careful consideration of the scope of exclusive rights. No one would consider denying consumers the right to use trademarks to order goods. No one would permit competitors' use of another's mark to defraud consumers. Between these extremes lies a variety of cases including comparative advertising and initial interest confusion. Each use has a different potential for affecting incentives,

---

[130] *Id.* at 63.

[131] Google, Inc. v. American Blind and Wallpaper Factory, Inc., No. C 03-5340JF (RS), 2007 WL 159950, at *1 (N.D. Cal. Apr. 18, 2007).

[132] *Compare* 800-JR Cigar, Inc. v. GoTo.com, Inc., 437 F. Supp. 2d 273, 285 (D.N.J. 2006) (by selling the right to have another's mark trigger a sponsored link, the search engine provider "trades on the value of the mark") *with* Merck & Co., Inc. v. Mediplan Health Consulting, Inc., 425 F. Supp. 2d 402, 415 (S.D.N.Y. 2006) (quoting 1-800 Contacts, Inc. v. WhenU.Com, Inc., 414 F.3d 400, 409 (2d Cir. 2005):

> A company's internal utilization of a trademark in a way that does not communicate it to the public is analogous to an individual's private thoughts about a trademark. Such conduct simply does not violate the Lanham Act, which is concerned with the use of trademarks in connection with the sale of goods or services in a manner likely to lead to consumer confusion as to the source of such goods or services.

At least one state has expressly made Internet initial interest confusion illegal by statute. In 2007, the Utah legislature amended the Utah trademark statute to create a right of a registered electronic trademark owner to enjoin use of a mark registered in the state's new electronic registration system "*to cause the delivery or display of an advertisement for a business, goods, or a service*." UTAH CODE ANN. § 70-3a-402 (2007) (emphasis added).

search costs, and competition. Whether the benefits of a particular use should be internalized depends on a balancing of those effects.

Application of the operational rules to sponsorship and post-sale confusion may give different results. Sponsorship confusion arises from consumers' mistaken belief that the seller was "in some way related to, or connected or affiliated with, or sponsored by," the mark owner.[133] One such use that has attracted a great deal of scholarly attention is the sale of clothing with the marks of athletic teams attached.[134] In some contexts, the use of the mark is such as to make consumers believe the source of the product is the team. These cases cause routine point-of-sale confusion, much like Internet use of another's mark in the advertisement or on the website of the advertiser.[135]

More interesting analytically are circumstances that make it clear that the supplier of goods is not associated with the mark owner in any way.[136] Courts have held in this context that confusion means not only the source of the goods, but the source of the trademarked symbol.[137] If a cap with the Boston Red Sox logo is sold with a clear indication that the source is not the Boston Red Sox, the effect of the use is more like Internet initial interest confusion than point of sale confusion. Even if consumers are not confused about the source of the goods, the user is gaining advantage from the goodwill of the Red Sox.[138]

---

[133] Amoco Oil Co. v. Rainbow Snow, 748 F.2d 556, 559 (10th Cir. 1984).

[134] *See*, *e.g.*, Alex Kozinski, *Trademarks Unplugged*, 68 N.Y.U. L. REV. 960 (1993); see *also* Bone, *supra* note 111, at 2144, concluding:

> [T]here is little in the way of trademark-related harm in merchandising cases, and the substantive policies favoring trademark protection are not strongly implicated. Moreover, there is no strong enforcement cost rationale for extending protection as far as courts do. The "propertization" critics are correct that many of these cases reflect problematic expansions of trademark law.

Id. at 2155.

[135] *See supra* text accompanying note 123.

[136] *See* Supreme Assembly, Order of Rainbow for Girls v. J. H. Ray Jewelry Co., 676 F.2d 1079, 1083 (5th Cir. 1982) (finding no infringement where there was no history of affiliation between fraternal organizations and jewelry makers bearing their marks and clear advertising distinguishing the "official supplier" from others).

[137] Boston Pro. Hockey Ass'n v. Dallas Cap & Emblem Mfg., Inc. 510 F.2d 1004, 1012 (5th Cir. 1975), *cert. denied*, 423 U.S. 868 (1975):

> The confusion or deceit requirement is met by the fact that the defendant duplicated the protected trademarks and sold them to the public knowing that the public would identify them as being the teams' trademarks. The certain knowledge of the buyer that the source and origin of the trademark symbols were in plaintiffs satisfies the requirement of the act. The argument that confusion must be as to the source of the manufacture of the emblem itself is unpersuasive, where the trademark, originated by the team, is the triggering mechanism for the sale of the emblem.

[138] *See* Kozinski, *supra* note 134, at 976-77:

Externality theory, public goods theory, and the misappropriation doctrine recommend analysis of the effect of this use on the team's incentives, consumer search costs, and competition. It might be that some activities rely on sale of articles showing affiliation with groups for essential support, diminishing incentives, while others do not. This conduct might make it much harder for those who want authentic team clothing to find it. If so, the conduct would raise search costs more than in the initial interest confusion example, though labeling could easily cure the problem. Because a team is more likely to license use of its mark on clothing, greater increase in compensation is likely to result from internalizing this externality. On the other hand, if there are more suppliers of team paraphernalia, competition is likely to lower prices and provide more variety of styles and quality. The differences between this type of sponsorship confusion and initial interest confusion may make a more compelling case for granting exclusive rights.

Perhaps an even more compelling case can be made for post-sale confusion. In post-sale confusion cases, the immediate buyer is not confused about the source of (often) counterfeit goods, but prospective buyers and/or the general public are likely to be confused.[139] Numerous harms may result from this type of use even if there is no confusion to buyers.[140] If the good, such as an designer handbag or watch, is a prestige good or scarce, competition by counterfeits might diminish the value to the buyers of real goods,[141] harming consumers and decreasing revenues to the trademark holder through competition that cannot be described as

---

> [Y]ou would have a strong claim to stencil your own Mets shirt or to make a banner praising the Mets-or burying them-to hang from your window on Central Park West. It's only a small step from there to say you ought to be able to pay someone to stencil the shirt or banner professionally. The other interests I've discussed would certainly also come into play, but the public's right to use the team's name, logo, and other images to express itself must be given a wide berth.

[139] *See* David M. Tichane, *The Maturing Trademark Doctrine of Post-Sales Confusion*, 85 TRADEMARK REP. 399 (1995) (discussing the history, development, and application of the doctrine and recommending its application to protect the goodwill of trademark owners). *Compare* Anne M. McCarthy, *The Post-Sale Confusion Doctrine: Why the General Public Should be Included in the Likelihood of Confusion Inquiry*, 67 FORDHAM L. REV. 3337, 3368 (1999) (concluding that point of sale confusion is irrelevant: "Confusion of any kind is a form of 'trespass' against the owner because his effort in developing an association with the mark is thwarted. Because any instance of confusion jeopardizes the goodwill cultivated by a trademark owner, confusion is contrary to the main tenets of trademark law.") *with* David Erlich, *When Should Post-Sale Confusion Prevent Use or Registration of Marks?*, 81 TRADEMARK REP. 267, 283 (1991) (recommending "a sliding scale in which the number of confused persons, the type and degree of confusion involved and the relationship of the confused persons to the parties are all considered").

[140] *See* Gen. Motors Corp. v. Keystone Auto. Indus., 453 F.3d 351, 358 (6th Cir. 2006) (listing harms associated with post-sale confusion).

[141] *See* Hermes Int'l v. Lederer de Paris Fifth Avenue, Inc., 219 F.3d 104, 108 (2d Cir. 2000).

being on the merits. Consumers desiring high quality goods may be harmed if the trademark owner must lower quality to be able to compete with counterfeit goods.[142] And the trademark owners' reputation for quality may be damaged if people other than the buyer mistakenly confuse an inferior counterfeit for the original. As a result, consumers may shun the mark owner's product line generally.[143] This harm might result even if the counterfeit is originally sold with clear notices about its origin.[144] This collection of possible harms may similarly be organized into effects on incentives, consumer search costs, and competition. Decreasing the value of advertising and the investment in quality directly affect incentives and prevent competition from satisfying consumers needs.

CONCLUSION

Externalities theory, public goods theory, and misappropriation theory all suggest a focus on both the incentives created by exclusive rights to intellectual property and benefits from free access. The operational rules from each approach are analogous. Externalities theory suggests that we protect works only when doing so creates more social benefits than costs. That is accomplished by incurring no greater social cost (by denying access and enforcing rights) than necessary to provide incentives to the creator (by internalizing external benefits). Public goods theory suggests promoting static efficiency consistent with maintaining dynamic efficiency. That is accomplished by permitting free access (denying exclusive rights) to the maximum extent consistent with providing optimal incentives (granting exclusive rights). Misappropriation theory protects free access to information until the point where access interferes with the profit-making necessary to provide incentives to produce the information. All point in the direction of a balancing of the same interests.

In trademark law, those interests are the creation of incentives to engage in trademarking activity and the use of marks to lower search costs and increase competition. Balancing these interests for any type of use of a mark requires weighing the benefits of exclusive rights and the benefits of free access. For Internet initial interest confusion cases, internalizing external benefits from free access is unlikely to increase the amount of product and source information. While initial interest confusion may raise search costs slightly in some cases, it also promotes competition. On balance, it seems appropriate to permit competitors to free ride on trademark owners' investments.

While the argument in this Article is based on theory, courts have relied on the same balancing considerations in trademark cases: incentives,

---

[142] *See* U.S. v. Torkington, 812 F.2d 1347, 1353 n.6 (11th Cir. 1987).

[143] Esercizio v. Roberts, 944 F.2d 1235, 1244 (5th Cir. 1991).

[144] *See Torkington*, 812 F.2d at 1353.

investment in goodwill, search costs, and competition. The very idea of trademarks is that they "lower consumer search costs and encourage higher quality production by discouraging free-riders."[145] "Trademarks desirably promote competition."[146] Trademarks are property rights but only in the sense that they are free from "unwarranted interference by others."[147]

The question is what interference is warranted. "Buyers who have reasonable alternatives to a particular seller's product are entitled to competition within the industry because 'such competition may lead to lower prices and improved quality.'"[148] When protection of a mark "would impede rather than promote competition and consumer welfare, an exception should be recognized."[149]

Courts that enjoin conduct leading to initial interest confusion tend to focus solely on goodwill, the dynamic efficiency side of the equation. They say that when consumers are diverted to another's website, the Internet advertiser "reaps the goodwill" of the trademark owner and the fact that consumers "are only briefly confused is of little or no consequence."[150] They conclude that what is important is not the duration of confusion but the misappropriation of goodwill.[151] The problem, they

---

[145] Union Nat. Bank of Texas, Laredo, Tex. v. Union Nat. Bank of Texas, 909 F.2d 839, 844 (5th Cir. 1990) (citing William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 268-70 (1987)).

[146] Park 'N Fly, Inc. v. Dollar Park & Fly, Inc., 469 U.S. 189, 193 (1985); *see also* Enterprises Rent-A-Car Co. v. Advantage Rent-A-Car, Inc., 330 F.3d 1333, 1337 (Fed. Cir. 2003) ("To protect trademarks . . . is to promote competition, and is sound public policy."); David W. Barnes & Teresa A. Laky, *Classic Fair Use: Confusion about Defenses*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 833, 838 (2004):

> Protecting goodwill also promotes competition. A new entrant to a market can use their own distinctive marks to establish brand recognition as well as a reputation for providing goods with reliable qualities and characteristics. By informing consumers about alternatives, new entrants use marks and establish goodwill to compete against existing suppliers to satisfy consumer demands.

[147] Barnes & Laky, *supra* note 146 (citing Hanover Star Milling Co. v. Metcalf, 240 U.S. 403, 413 (1915) (emphasis added)).

[148] *Id.* at 838-39 (citing an antitrust case, United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 425 (1954)):

> Ultimately, the benefit of protecting mark owners' goodwill is to consumers, who may rely on the qualities and characteristics of the supplier's goods conveyed through the mark and appreciate the advantages of vigorous competition. This lowers prices and increases available alternatives to satisfy consumers' diverse tastes. This reliance reduces consumers' cost of seeking information about goods, including not just reading labels, advertising, and literature, but acquiring experience by buying and rejecting unsuitable goods.

[149] Peaceable Planet, Inc. v. Ty, Inc., 362 F.3d 986, 989 (7th Cir. 2004).

[150] Promatek Industries, Ltd. v. Equitrac Corp., 300 F.3d 808, 812 (7th Cir. 2002).

[151] *See id.* at 813.

say, is that the advertiser is "capitalizing on the trademark holder's goodwill."[152] It is a "violation of the Lanham Act," they say, to "use the goodwill associated with Plaintiff's trademark in such a way that consumers might be lured to the [products] from Plaintiff's competitors."[153]

Courts accepting claims of Internet initial interest confusion offer no limits on internalization of externalities and ignore balancing. In the fair use context, the Supreme Court has opened the door to considering the balance of other interests against the potential for likelihood of confusion. The mixed public goods nature of trademarks means that that the balance between incentives and access might differ for different uses of trademarks. The discussion of Internet initial interest confusion, sponsorship confusion, and post-sale confusion illustrate how to perform this balancing.

There are two intriguing aspects of evolving theories of copyright and patent law. The first is how well they mesh with more traditional theories. Externality theory from 2005 and 2007 recapitulates public goods theory applied to intellectual property in the 1980s.[154] Misappropriation doctrine from 1918 embodies the prescriptions of theory developed decades later. The second is how theory developed for copyright and patent law, the creativity domain of intellectual property law, applies to trademark law, the fraud domain. The three approaches to determining the optimal scope of copyright and patent protection are equally useful in analyzing trademark issues.

---

[152] Australian Gold, Inc. v. Hatfield, 436 F.3d 1228, 1239 (10th Cir. 2006).

[153] *Id.*

[154] *See* Gordon, *supra* note 11, at 1610.