

**Trademark Dilution, Search Costs, and  
Naked Licensing**

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**USC Center in Law, Economics and Organization  
Research Paper No. C05-16  
USC Legal Studies Research Paper No. 05-23**



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## Trademark Dilution, Search Costs, and Naked Licensing

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### Abstract

Trademark dilution needs to be rethought to ensure that it enhances social welfare. Blurring should only be considered harmful when it increases consumer search costs. The fact that a trademark calls to mind two different products should not itself be considered actionable. Blurring only causes real harm when it interferes with consumers' ability to remember brand attributes. The Coase Theorem suggests that anti-dilution statutes will not block beneficial, non-competing uses of a mark, because, if transactions costs are low and the use is socially beneficial, the trademark owner will license the use. Unfortunately, the "naked licensing" rule, which forbids unsupervised licenses, adds unnecessary transactions costs and blocks potentially beneficial uses. Some commentators think free riding is or should be the essence of dilution. If free riding causes no harm – no consumer confusion, no blurring, and no tarnishment – then it is socially beneficial and should be allowed.

# Trademark Dilution, Search Costs, and Naked Licensing

Daniel Klerman\*

September 23, 2005

Speaking for a unanimous court, Justice Stevens's opinion in *Victor's Little Secret*<sup>1</sup> held that plaintiffs in dilution cases must prove "actual dilution," which most courts and commentators interpret as requiring proof of "actual harm."<sup>2</sup> The opinion said relatively little, however, about the nature of dilutive harm or how it is to be proved. This article argues that *Victor's Little Secret* should spur litigants, experts, judges, and academics to think more deeply about the harms dilution may cause. In particular, it argues (a) that blurring should only be considered harmful when it increase consumer search costs, (b) that the rule against "naked licensing" should be relaxed to encourage beneficial but potentially dilutive licensing, and (c) that free-riding should not be considered actionable.

Blurring occurs when a single trademark denotes products made by different firms. It will be argued, however, that this phenomenon in and of itself is not harmful. Blurring is only harmful when it interferes with consumers' ability to remember information about products and brands and thus increases search costs.

Many commentators opposed the creation of the dilution cause of action, because they thought it would forbid socially beneficial uses of trademarks by non-competing firms. The Coase Theorem, however, suggests that, if transactions costs are low, such beneficial uses will still occur, because the trademark owner and non-competing user will negotiate a licensing agreement. The "naked licensing" rule, however, has long forbidden licensing without quality supervision by the trademark owner.<sup>3</sup> This doctrine increases the costs of licensing and thus impedes potentially beneficial non-competing

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<sup>1</sup> *Moseley v. V Secret Catalogue*, 537 U.S. 418 (2003).

<sup>2</sup> See, e.g., *Nissan Motor Co. v. Nissan Computer Corp.*, 378 F.3d 1002, 1110 ((9<sup>th</sup> Cir. 2004) ("Injunctive relief is available ... if ... there is actual harm to the trademark owner, *Moseley v. V. Secret Catalogue*..."); *Four Seasons Hotels and Resorts B.V. v. Consorcio Barr*, 267 F. Supp. 2d 1268, 1332 (S.D. Fla. 2003) (interpreting *Moseley* as "requiring evidence of actual harm"); David J. Franklyn, "Debunking Dilution Doctrine: Toward a Coherent Theory of the Anti-Free-Rider Principle in American Trademark Law," 56 *Hastings L. J.* 117, 166 (2004-2005) ("the United States Supreme Court has made matters worse by ruling that dilution requires proof of actual harm."); Meredith Blaise Switzer, "Annual Survey of Caselaw: Intellectual Property," 26 *U. Ark. Little Rock L. Rev.* 933, 933 (2004) ("The Supreme Court reversed the Sixth Circuit and held that a trademark dilution plaintiff must show actual harm..."); Stacey L. Dogan and Mark A. Lemley, "Trademarks and Consumer Search Costs on the Internet," 41 *Houston L. Rev.* 777, 790 n. 42, 826 (2004) (interpreting *Victor's Little Secret* as "requiring actual harm.")

<sup>3</sup> J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition*, §§ 18:42 & 18:48 (2005); Rudolph J. Kuss, "The Naked Licensing Doctrine Exposed: How the Courts Interpret the Lanham Act to Require Licensors to Police their Licensees & Why this Requirement Conflicts with Modern Licensing Realities and the Goals of Trademark Law," 9 *Marq. Intell. Prop. L. Rev.* 361 (2005); Kevin Parks, "'Naked' is not a Four-Letter Word: Debunking the Myth of the 'Quality Control Requirement' in Trademark Licensing," 82 *Trademark Rep.* 531 (1992).

uses. While the rule may have some justification as applied to competitive or related uses, where there is a danger of consumer confusion, there is no comparable justification for application of the doctrine to non-competitive, unrelated uses.

Some commentators have suggested that free-riding is the essence of dilution, either in theory or in practice.<sup>4</sup> The diluting user is taking advantage of the original, famous mark's goodwill without consent or compensation, and, they argue, this free-riding should be actionable dilution. Nevertheless, if the second user is not in any way harming the senior user<sup>5</sup> – increasing search costs, tarnishing the senior user's reputation, or causing some other injury – the second use is socially beneficial and should be allowed.

Part I provides some brief background on trademark dilution and *Victor's Little Secret*. Part II analyzes blurring. Part III discusses how the naked licensing doctrine impedes beneficial licensing transactions. Parts IV and V analyze the tarnishment and free riding theories of dilution.

## I. Background

Trademarks can be violated in two different ways: by infringement and by dilution. Trademark infringement, which is the older cause of action, is the use of another's trademark which causes confusion, usually consumer confusion. Thus, if a jeweler unaffiliated with the original Tiffany & Co. opens a store and calls it "Tiffany's," consumers are likely to believe that the store is affiliated with the famous Tiffany brand. As a result, the unaffiliated Tiffany's store infringes the Tiffany & Co. trademark. The social harm inherent in infringement is relatively clear. Because it benefits from the good reputation of the original Tiffany, the unaffiliated Tiffany's has little incentive to invest in quality. Consumers who buy at the unaffiliated store are therefore unlikely to receive goods of the quality they expected. More subtly, even the original Tiffany's will have less incentive to maintain quality, because if consumers cannot distinguish between original and unaffiliated Tiffany stores, but eventually realize that the quality they receive is not always as high as they expected, they will be less willing to pay a high price even for genuine Tiffany products..

In the early twentieth century, courts often held that infringement could only occur when the plaintiff's and defendant's products competed in the same market.<sup>6</sup> This restriction was justified by the fact that the same trademark is often used on non-competing products without causing any consumer confusion. For example, few consumers believe the United Airlines and United Van Lines are the same company. Nevertheless, since companies sometimes expand their product lines, consumers could be confused even in situations where there is currently no competition, but where such competition might plausibly occur in the future. For example, even though there is currently no Mercedes pick-up truck, if a firm unaffiliated with Mercedes produced a

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<sup>4</sup> See Franklyn, *supra* note \_\_. .

<sup>5</sup> Of course, the free rider could be seen as "harming" the trademark owner by depriving the owner of potential licensing revenue. The harms referred to here are the harms caused by consumer confusion, blurring and tarnishment, not the mere reduction in licensing revenue.

<sup>6</sup> McCarthy, § 24:2.

pick-up truck embossed with the Mercedes name and hood ornament, many consumers would likely be confused into thinking that the truck was produced by the famous German automaker. On the other hand, it is implausible to think that Mercedes would start producing milk. As a result, if someone unaffiliated with Mercedes started marketing milk under the Mercedes name, there would be no infringement, because (at least according to the courts), no consumer would be confused into thinking that the famous German automaker produced or sponsored the milk. As a result, modern courts require that that goods be “related,” although not necessarily competing, for there to be trademark infringement.<sup>7</sup>

Dilution is “the lessening of the capacity of a famous mark to identify and distinguish goods or services, regardless of the presence or absence of (1) competition between the owner of the famous mark and other parties, or (2) likelihood of confusion, mistake, or deception.”<sup>8</sup> Although the definition of dilution alludes to the outdated requirement of competition, it is universally understood that dilution can occur even where the goods are unrelated. Dilution is usually thought to occur in two ways: blurring and tarnishment. Some commentators believe dilution may occur when there is free riding on the good will of a famous trademark, even if there is no confusion, blurring, or tarnishment.<sup>9</sup>

Tarnishment is the use of a trademark in a way which creates negative associations, usually illegality or immorality. For example, a poster with the words “Enjoy Cocaine” in Coca-Cola’s distinctive white-on-red cursive would tarnish the Coca-Cola trademark by associating it with illicit drugs.<sup>10</sup>

Blurring is use of a mark on unrelated goods in ways that do not tarnish the original mark, but which weaken the link between the mark and the product originally associated with the mark. A classic example is a restaurant called “Tiffany’s.” Most courts would hold that there would be no infringement in such a case, because the famous jeweler is unlikely to open a restaurant, and thus consumers would not be confused into thinking that the famous jeweler owned, sponsored or otherwise stood behind the

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<sup>7</sup> *Id.* § 24:5. This, at least, is the black-letter law. It is difficult to find modern cases where courts have found the products so unrelated to preclude confusion. When products appear unrelated, courts may turn to the concept of sponsorship confusion. *Id.* § 24:7.

<sup>8</sup> 15 U.S.C. § 1127.

<sup>9</sup> See Franklyn, *supra* note \_\_. Dilution law is sometimes used to justify restrictions on knock-offs where, because of the context of purchase (e.g. low-priced street vendors), there is no consumer confusion. Clarisa Long, “Dilution,” (unpublished manuscript); William M. Landes and Richard A. Posner, *The Economic Structure of Intellectual Property Law* (2003) pp. 208-9. Nevertheless, knock-offs can be controlled through the traditional trademark infringement law, so recourse to dilution is unnecessary. The trademark infringement statute refers to confusion, but does not specify that that confusion must be by consumers. Some courts, therefore, find infringement when third parties are confused. As a result, knock-offs will not be discussed here. The author discusses them in a related, unpublished article. “The Expressive Function of Trademarks,” (1999); See also, Stacey Dogan & Mark Lemley, “The Merchandising Right: Fragile Theory or Fait Accompli,” 54 *Emory L. J.* 461 (2005).

<sup>10</sup> It should be noted that, in dicta, Justice Stevens’ opinion in *Victor’s Little Secret* questioned whether the federal statute actually forbade tarnishment. 537 U.S. at 432. See Layne Smith, “Tarnishment and the FTDA: Lessening the Capacity to Identify and Distinguish,” 2004 *B.Y.U. L. Rev.* 825 (2004). Nevertheless, lower courts continue to treat tarnishment as a valid cause of action under the federal anti-dilution statute.

restaurant.<sup>11</sup> Nevertheless, for those aware of the restaurant, the Tiffany's mark would no longer denote only the jeweler, but also the restaurant. Other examples of blurring include Buick aspirin and DuPont shoes.<sup>12</sup>

A third theory of dilution relies solely on the idea of free-riding. Suppose, for example, that the Tiffany's restaurant did not in fact tarnish or blur the Tiffany's mark---the restaurant was of very high quality, and, even after repeatedly seeing advertisements for Tiffany's restaurant, consumers continued to associate the Tiffany mark exclusively (or at least overwhelmingly) with the jeweler. Even so, one might argue that the restaurant should not be able to use the Tiffany name, because it is free-riding on the jewelry store's reputation. No doubt the restaurant adopted the name "Tiffany's" because of the positive associations that the jewelry store had created. The jewelry store created those associations through investments in quality products, quality service, and advertising. The restaurant, so it is argued, should not be able to take advantage of those investments without the jeweler's consent.<sup>13</sup>

Although some states adopted anti-dilution laws in the mid-twentieth century, there was no federal anti-dilution law until 1995. The circuits soon split on whether the federal statute requires "actual harm" or whether "likelihood of dilution" is sufficient. The Supreme Court granted certiorari in *Victor's Little Secret* to resolve that split. Justice Stevens' opinion relied primarily on the text of the statute. The federal trademark infringement statute refers to "likelihood of confusion," and many state anti-dilution statutes refer to the "likelihood of dilution." In contrast, the federal anti-dilution statute does not refer to "likelihood of dilution" or employ similar probabilistic terms, but forbids only "dilution." As a result, the Court held that proof of "actual dilution" was required. The Court, however, rejected the idea that "the consequences of dilution, such as an actual loss of sales or profits, must also be proved." Instead, the Court stated that consumer surveys could provide "direct evidence of dilution," and that unspecified "circumstantial evidence" could be sufficient, especially where the senior and junior marks were identical. In the two-and-a-half years since the decision was handed down, courts and commentators have lamented the fact that the Court was not more specific in identifying what evidence would be sufficient to prove dilution.<sup>14</sup>

Although most courts and commentators interpret the decision as requiring "actual harm," this is not absolutely clear. The opinion does say that it took the case in order to resolve the circuit split over whether "actual harm" is required.<sup>15</sup> On the other hand, the opinion uses the phrase "actual harm" only when describing the decisions of lower courts.<sup>16</sup> In its own analysis, the Court uses the phrase "actual dilution."<sup>17</sup> The

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<sup>11</sup> *Ty v. Perryman*, 306 F.3d 509 (7<sup>th</sup> Cir. 2002) (Posner, J.) ("There is little danger that the consuming public will think it's dealing with a branch of the Tiffany jewelry store if it patronizes this restaurant."); McCarthy's, § 24:68; but see *Tiffany & Co. v. Boston Club*, 231 F. Supp. 836 (D. Mass. 1964) (finding Lanham Act infringement as well as dilution by Tiffany's restaurant and lounge).

<sup>12</sup> *Moseley v. V Secret Catalogue*, 537 U.S. 418, 431, (2003); McCarthy's, § 24:68.

<sup>13</sup> Franklyn, supra note \_\_.

<sup>14</sup> Thomas R. Lee, "Demystifying Dilution," 84 B.U. L. Rev 859, 863 (2004) ("Moseley raises at least as many questions as it answers. Its core holding is inherently unstable....").

<sup>15</sup> 537 U.S. at 428.

<sup>16</sup> 537 U.S. at 427, 428, .

<sup>17</sup> 537 U.S. at 433, 434.

Court probably thought that these two phrases were identical. Nevertheless, as the discussion below will reveal, there may be “actual dilution” without any “actual harm.”

In response to *Victor’s Little Secret*, the House of Representatives passed the Trademark Dilution Revision Act of 2005, which, among other changes, would eliminate the “actual dilution” requirement, by allowing relief when an unauthorized use “is likely to cause dilution.”<sup>18</sup> As of the writing of this article, no action on the bill has been taken in the Senate.

## II. Blurring

The harm caused by trademark dilution is elusive. Courts, commentators, and legislative committees use vague and unhelpful terms, such as reduction in a mark’s “selling power” or “advertising value,” or the “whittling away” of a mark’s distinctiveness.<sup>19</sup> In my opinion, the most convincing analysis of dilution’s harm can be found in William Landes and Richard Posner, *The Economic Structure of Intellectual Property Law* (2003). Nevertheless, as will be discussed below, even this analysis is incomplete.

With regard to blurring, Landes and Posner argue:

Suppose elite brand names, such as “Tiffany” and “Rolls Royce” were appropriated only by producers of equally fine products. Nevertheless, the distinctiveness of the marks as identifiers of the products sold by the Tiffany and Rolls Royce companies would be reduced. More mental time and effort—the “imagination cost” to which we referred in Chapter 6--<sup>20</sup> would be required to associate the name with a particular product. The result would be an increase in consumer search costs. This is the “blurring” effect of which the dilution cases speak.<sup>21</sup>

There is some empirical evidence that blurring increases consumer’s “mental time and effort.” In a study performed by Maureen Morrin and Jacob Jacoby, some participants were shown ads for hypothetical diluting products, such as Heineken popcorn, while others (the control group) were shown unrelated ads.<sup>22</sup> Both groups were then presented

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<sup>18</sup> H.R. 683, section 2 (passed the House April 19, 2005).

<sup>19</sup> 537 U.S. at 427, 429; Frank I. Schechter, “The Rational Basis of Trademark Protection,” 40 Harv. L. Rev. 813 (1927).

<sup>20</sup> The only discussions I could find in Chapter 6 of “imagination cost” are the following: “A trademark seeks to economize on information costs by providing a compact, memorable, and unambiguous identifier of a product or service. The economy is less when, because the trademark has other associations, a person seeing it must think for a moment before recognizing it as the mark of the product or service.” *Economic Structure* at 161. “[T]he availability heuristic may be consistent with rationality once one acknowledges that imaginative reconstruction requires more ‘effort’ (that is, cost) than immediate perception; in other words, once thinking is understood to be a costly activity.” *Id.* at 161 n. 31.

<sup>21</sup> *Id.* at p. 207.

<sup>22</sup> Maureen Morrin and Jacob Jacoby, “Trademark Dilution: Empirical Measures for an Elusive Concept,” 19 J. Pub Policy & Marketing 265 (2000). It should be noted that the authors did not conceive of this study as measuring the effect of dilution on search costs. Rather, their study was designed to test “an associative network model of the structure of brand information stored in long-term memory.” *Id.* at 265.

with a number of word pairs (e.g., Heineken/beer, Heineken/hotel) and asked whether the words were a “match.” Persons exposed to advertisements for diluting products were more likely to make mistakes in matching brands to products and product attributes. For example, survey participants exposed to ads for Heineken popcorn agreed that Heineken was a brand of beer 82.8% of the time, whereas those who had not been exposed to the popcorn ads agreed 92.1% of the time. In addition, even when consumers correctly matched brands with products and attributes, they took longer to do so. For example, persons exposed to diluting ads who correctly identified Heineken as a brand of beer took, on average, 770 milliseconds to do so, versus 645 seconds for those not exposed to the diluting ads.<sup>23</sup>

While this study is suggestive, it does not establish that blurring causes harm. First, although the study found an effect for some brands (such as Heineken), it failed to find an effect on other brands (such as Hyatt).<sup>24</sup> This suggests that blurring may be a much more complex phenomenon and that some brands may be resistant to harm. Later research by Morrin and others, for example, suggests that the more famous the brand, the less subject it is to blurring.<sup>25</sup>

Second, although the study found some increase in “mental time,” the increase is not economically significant. Those exposed to diluting advertising took only 125 milliseconds longer than others to link brand to product or attribute. This is barely a tenth of a second. Even for someone earning \$250 per hour, the increase in search costs would be less than a penny.<sup>26</sup>

Third, the study did not distinguish between four different mental tasks—remembering the product(s) associated with a brand if prompted with the brand, remembering relevant brands if prompted with the product category, remembering product attributes if prompted by a brand, and remembering brands having particular attributes if prompted by attributes. For example, dilution might interfere with the ability of consumers to remember that Heineken is a beer if prompted by a picture of the Heineken trademark, but consumers might still be able to remember that Heineken is a brand of beer, if they were asked to list brands of beer. The latter is much more relevant to consumer behavior and to the identification of the harm caused by blurring. If a consumer is thinking about buying beer, it is helpful if the consumer can remember several relevant brands so she can choose among them. It is hard to think of situations where consumer search is aided by the ability to remember the product category associated with a brand. Consumers just don’t confront trademarks in the abstract very often, and, when they do, context usually makes the product category obvious.<sup>27</sup> If

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<sup>23</sup> Id at 269. The results discussed here are for the control group which was shown unrelated ads, rather than ads for the diluted or original products.

<sup>24</sup> The study also found an effect for a third brand, Godiva, but the experiment involved tarnishment rather than blurring. Id. See below.

<sup>25</sup> Maureen Morrin, Jonathan Lee, and Greg Allenby, “Determinants of Trademark Dilution” \_\_ J. Consumer Research \_\_ (forthcoming Sept 2006).

<sup>26</sup>  $(\$250 * 0.125 \text{ seconds}) / (60 \text{ minutes} * 60 \text{ seconds/minute}) = 0.87 \text{ cents}$

<sup>27</sup> One place where a consumer might encounter a brand in the abstract is telephone white pages, although even here entries are likely to mention category – “Tiffany & Co. Jewelers” rather than simply “Tiffany & Co.” Another context where brand names are used in the abstract is internet searching. Nevertheless, the fact that search engines are likely to list the famous brand’s website first eliminates any harm here. People sometimes mention brands in the abstract in conversation, but the relevant category is usually apparent from context. When a person complains about United’s cramped seating, it’s clear that he



someone says, “Tiffany’s has a good selection of diamonds,” it would be obvious that Tiffany & Co jewelers is intended, not the restaurant. When consumers are searching for a product, the relevant product category is usually obvious or assumed.

Although the ability to remember brands in a particular product category may sometimes be helpful in identifying which products one might want to buy, it is often unnecessary. If the consumer goes to a grocery or liquor store to buy beer, all the relevant brands are likely to be shelved next to one another, so the ability to remember relevant brands may not be that important. In this situation, the ability to remember the attributes of each brand—bitterness, smoothness, heaviness, whether they have additives, which brands friends prefer, etc—is probably more important for consumer search. For this task, the relevant survey question is whether, having seen the branded product, consumers can remember its attributes. On the other hand, consumers sometimes choose first the characteristics they want, then the brand, and then the store likely to stock the brand. In such situations, the relevant survey questions would be (1) whether, having been prompted by the product category (beer), the consumer can identify the brand (Heineken), and (2) whether having identified the brand, she can recall its attributes (smoothness, bitterness, etc.). Without information on these distinct questions, it is difficult to know whether blurring causes any significant harm, or to identify when those harms occur.

It is also possible that blurring increases search costs in a more straightforward way. While blurring and infringement are usually seen as distinct, it is possible that laws against blurring help prevent the sort of consumer confusion which is at the heart of infringement. To prove infringement, the plaintiff must show confusion or likelihood of confusion among a significant portion of the population. If surveys suggest that less than ten percent of people are likely to be confused, courts usually find no infringement.<sup>28</sup> One reason courts fail to find infringement in such circumstances is that some proportion of survey respondents are likely to be confused no matter what the question, so ten percent or less may indicate no increase in confusion attributable to the defendant’s product.<sup>29</sup> Nevertheless, such survey results may also suggest some avoidable confusion.

In addition, some consumers may think that similar or identical marks used even on non-competing, completely unrelated products indicate that the products are produced by the same entity. In a world in which the Virgin Group operates airlines and produces music, this confusion is not entirely irrational. As applied by the courts, infringement is presumed to be impossible where the products are unrelated.<sup>30</sup> That presumption may be

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is talking about the airline, not the moving service. Perhaps anti-dilution laws could be justified as reducing the need for advertisers to remind consumers the relevant product category. In Tom Lee’s view, anti-dilution laws would thus reduce “maintenance costs.” Thomas R. Lee, “Demystifying Dilution,” 84 B.U. L. Rev 859, 898 (2004). It is an interesting empirical question whether anti-dilution laws have led to such cost reductions, a phenomenon which perhaps could be measured by counting the number of advertisements which include no mention (aural or visual) of the product itself or the relevant category. My suspicion is that advertisements for all but most famous brands must mention the product or product category no matter what the law is, because they cannot assume that consumers have already made the connection between brand and product category. That is, the key problem faced by advertisers is not multiple associations with the brand, but none at all.

<sup>28</sup> McCarthy, §§ 32-188 and 32-189

<sup>29</sup> Ibid § 32-187.

<sup>30</sup> *AMF v. Sleekcraft Boats*, 599 F. 2d 341, 3438 (9<sup>th</sup> Cir. 1979) (“If the goods are totally unrelated, there can be no infringement because confusion is unlikely.”)

false. The blurring cause of action may therefore reduce search costs by preventing the consumer confusion which courts mistakenly assume use of similar marks on unrelated products doesn't produce.

Although the forgoing discussion suggests that blurring may increase search costs—either by impairing memory about product attributes or by causing consumer confusion as to product origin – the increase in search costs may be quite small. On the other hand, the costs of the blurring cause of action may be substantial. The existence of anti-blurring legislation leads to lawsuits, the need to investigate whether a new trademark might blur an existing one,<sup>31</sup> and the need to negotiate licenses for what otherwise would be free. If blurring increases search costs only a little, the costs of the blurring cause of action may outweigh its benefits.

### III. The Coase Theorem and Naked Licensing.

Of course, even if blurring causes some harm (an increase in search costs), it is also possible that blurring also confers benefits which exceed that harm. For example, even if the existence of a Tiffany's restaurant increases the cost of searching for jewelry, the use of the Tiffany mark on a restaurant might have even larger benefits. As Landes and Posner point out in their discussion of tarnishment, favorable associations are a social benefit.<sup>32</sup> If calling a restaurant "Tiffany's" causes consumers to have a more pleasurable dining experience, that's a social benefit. Of course, according to the Coase Theorem, if there are no transactions costs and the social benefits exceed the costs, laws against blurring would not block the opening of a Tiffany's restaurant. The restaurant would simply negotiate a license to use the Tiffany mark. Of course, there are transactions costs. In addition to the ordinary transactions costs of negotiating and enforcing licenses, trademark law imposes an additional cost – supervision by the trademark owner of the quality of the blurring use. The "naked licensing" doctrine forbids licensing unless the trademark owner polices the licensee.<sup>33</sup> Failure to supervise can result in cancellation of the mark or can give infringers a defense.<sup>34</sup> The fear of forfeiture would thus make trademark owners reluctant to license potentially blurring uses, or would induce them to demand higher licensing fees in order to offset the cost of monitoring and the danger of cancellation of the mark.

The naked licensing doctrine is justified as consumer protection. If the trademark owner doesn't supervise licensees, consumers may end up purchasing goods of lower quality than they expected. Although this rationale can (and has been) much criticized, it at least has surface plausibility where the licensee is in the same market, or at least a market which is sufficiently related that consumers might be confused.<sup>35</sup> Blurring, however, is only relevant when there is little danger of confusion. In such circumstances, the doctrine has no justification. It was developed before dilution became a cause of action, and it has remained on the books, unexamined. Now that there is legislation

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<sup>31</sup> Clarisa Long calls these "avoidance costs." Clarisa Long, "Dilution," (unpublished manuscript);

<sup>32</sup> *Economic Structure*, supra note \_\_, at 207.

<sup>33</sup> See supra, n. \_\_,

<sup>34</sup> Kuss, supra n. \_\_, at 363.

<sup>35</sup> See supra n. \_\_.

against dilution, the doctrine causes real harm by preventing socially beneficial licensing agreements.

Nevertheless, even if the naked licensing doctrine were abolished, I suspect that there would be relatively little licensing. The benefits to the licensee are likely to be small, so potential licensees would be willing to pay relatively little. On the other hand, brand managers would probably demand relatively high prices to compensate for five possible disadvantages to licensing: (1) the low levels of consumer confusion, discussed above, that use of the mark on an unrelated product could cause,<sup>36</sup> (2) the possibility that the unrelated product might, in the future, have a tarnishing effect, perhaps because of a safety problem or management scandal, (3) uncoordinated associations that use of the mark on an unrelated product could cause, (4) fear that the license would be interpreted as endorsement, and (5) the need to inform consumers, through advertising or other means, that the licensee is not otherwise affiliated, so as to prevent or minimize harms (1) through (4).<sup>37</sup> Concerns (4) and (5) require some further explanation.

Even if the licensed product were of high quality, it could interfere with the associations that the owners of the mark had created for the original product. For example, if the trademark owner had created a sporty image for its product, but the licensed product had a refined, restful image, the licensed product could interfere with consumers' image of the original product, even if the licensed product were of high quality.

Trademark owners might also fear that consumers would interpret the license as an endorsement of the licensed product, and thus use the licensed product to make quality inferences about the original. That is, licensing might create confusion as to source. Even if consumers had no direct knowledge of the license, if unauthorized blurring uses were forbidden, consumers would rationally infer a license from the unchallenged existence and marketing of the product.

#### IV. Tarnishment

With regard to tarnishment, Landes and Posner observe that it is common for people to be willing to pay a premium for items with positive associations. For example, ordinary objects formerly owned by Jacqueline Kennedy Onassis have sold for astronomical prices. Similarly, people avoid negative associations---few people today name their children "Adolf." Because of this psychological phenomenon, Landes and Posner suggest that tarnishment would "impose a cost."<sup>38</sup> Consumers would be less willing to buy a product after it has been tarnished, or willing to buy it only at a lower price. Nevertheless, while this explains why trademark owners fear tarnishment, it does not explain why tarnishment is a social harm. One might, for example, believe that tarnishment simply causes consumers to purchase equally good (or superior) items produced by a competitor. If so, the loss to the owner of the tarnished trademark might be exactly offset by the gains to the competitor.

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<sup>36</sup> See *supra*

<sup>37</sup> Tom Lee and David Welkowitz call this last consideration "maintenance costs." Thomas R. Lee, "Demystifying Dilution," 84 B.U. L. Rev. 859, 898 (2004); David Welkowitz, "Reexamining Trademark Dilution," 44 Vand. L. Rev. 531, 543 (1991).

<sup>38</sup> *Economic Structure*, *supra* note \_\_\_, at 207.

Further reflection, however, suggests that, in most cases, there are likely to be four kinds of genuine social losses. First, those who purchased the product before its tarnishment, are likely to be harmed, as they will derive less pleasure from it now that it has negative associations. For example, someone who purchased Godiva chocolate and then saw advertisements for Dogiva dog biscuits is likely to derive much less enjoyment from eating the chocolate, because the chocolate will now evoke association with dog food. In such cases, tarnishment may ruin the tarnished product.

Second, even if tarnishment causes consumers to purchase substitutes of similar quality, there is some loss of consumer surplus. For example, suppose after seeing advertisements for Dogiva dog biscuits, a consumer who previously would have purchased Godiva chocolate purchases See's chocolate. The fact that the consumer previously would have purchased Godiva implies that, prior to the tarnishment, she would have expected to receive more consumer surplus from purchasing Godiva chocolate than See's chocolate. Because of the tarnishment, she now purchases a less preferred chocolate and receives less consumer surplus.

Third, the activity which causes tarnishment, typically advertising, is often socially costly, so even if the harm and benefit which flow from tarnishment have no net effect, once the cost of advertising is included in the calculus, tarnishment is a net loss to society.

Fourth, the owner of the mark which is tarnished may respond by trying to restore its brand's positive associations, and those efforts (again, typically advertising) are socially costly.

None of these reasons are valid in all cases. The first—harm to those who purchased the product before its dilution—applies primarily to durable goods. If the good or service has already been consumed before the tarnishment occurs, there is unlikely to be any harm, except perhaps if the tarnishment causes unpleasant (or less pleasant) memories of the product or service. The second reason – consumer substitution to a less preferred product – applies whenever the consumer was not previously indifferent between the tarnished product and its substitute, but in many cases, this harm is likely to be very small. In competitive markets, substitutes (See's chocolate and Godiva chocolate) are likely to be quite close in quality. The third reason—the socially costly nature of the tarnishing activity itself, e.g. advertising— does not apply when the tarnishing activity has some independent social value, as is the case when the tarnishing activity is the production of a separate product. For example, an “Enjoy Cocaine” poster may have independent value, as evidenced by the fact that people are willing to pay for it. In addition, even if the tarnishment was caused by advertising, the second reason is valid only if the tarnishing entity would otherwise have engaged in less advertising or advertising of a more informative kind. The fourth harm—the social cost of responsive advertising—is of course inapposite if the trademark owner decides that no response is the best response. In spite of these limitations, the four reasons presented above provide some plausibility to the idea that tarnishment causes actual harm.

Tarnishment may also increase search costs. The study discussed above found that tarnishment, like blurring, led consumers to make more errors in matching brands to products and product attributes, and increased the time it took to make correct matches.<sup>39</sup>

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<sup>39</sup> Maureen Morrin and Jacob Jacoby, “Trademark Dilution: Empirical Measures for an Elusive Concept,” 19 J. Pub Policy & Marketing 265, 269-70 (2000) (Godiva and Dogiva experiment).

As with the prior discussion of blurring, relaxation of the naked licensing doctrine would help ensure that the tarnishment cause of action blocked only uses which cause net social losses. As noted above, there will be some circumstances in which there are social benefits to the tarnishing use. One way of dealing with such cases is to create doctrines, such as a parody defense, which immunize whole categories of potentially tarnishing uses. Another strategy is to rely on private negotiation. If the benefits of the tarnishing use outweigh the harms, the tarnishing user may be able to negotiate a license. As noted above, however, the naked licensing doctrine impedes such negotiations without providing any corresponding benefit, and should be relaxed. Of course, even if the naked licensing prohibition is repealed, there is no guarantee that all beneficial tarnishing uses will be licensed. Many uses, such as parody, provide consumers benefits which exceed the price paid. Unless the tarnishing user is able to perfectly price discriminate, it will not capture the full benefits of the use. As a result, it may be unable to pay a licensing fee sufficient to compensate the trademark owner for the harm, even if there is a net social benefit.

#### IV. Free Riding

A third theory of dilution relies solely on the idea of free-riding. Suppose, for example, that the Tiffany's restaurant did not in fact blur or tarnish the Tiffany's mark--the restaurant is of very high quality, and, even after repeatedly seeing advertisements for Tiffany's restaurant or even eating there, consumers had no difficulty remembering the attributes of Tiffany jewelry or that that Tiffany is a brand of jewelry. Even so, one might argue that the restaurant should not be able to use the Tiffany name, because it would be free-riding on the jewelry store's reputation. No doubt the restaurant adopted the name "Tiffany's" because of the positive associations that the jewelry store had created. The jewelry store created those associations through investments in quality products, quality service, and through advertising. It is unfair, so it is argued, for the restaurant to take advantage of those investments without consent and/or compensation.<sup>40</sup>

The problem with this argument is that, if the junior user benefits (as evidenced from its desire to use the mark), but there is really no harm (no confusion, no blurring, no tarnishment), then it is socially desirable for the junior user to use the mark. In fact, allowing the use is pareto superior--the junior user and its customers benefit, and no one is harmed. Giving the senior user the right to enjoin the use either blocks beneficial transactions or, if the parties negotiate a license, adds transactions costs. Because of the policy against naked licensing,<sup>41</sup> the most likely outcome would be to block most transactions. Even if licenses could be negotiated, the associated transactions costs would only be justified if they had some socially beneficial *ex ante* effect.

Landes and Posner suggest that preventing free-riding could increase incentives to invest in the creation of prestigious names. "If the appropriation of the mark without the permission of [the famous trademark owner] were nevertheless forbidden, the benefits of its investment in creating a famous name would be more completely internalized and the

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<sup>40</sup> Franklyn, *supra* note \_\_\_. For a critique of free-riding arguments more generally, see Mark Lemley, "Property, Intellectual Property, and Free Riding," 83 Texas L. Rev. 1031 (2005).

<sup>41</sup> See above \_\_\_.

amount of investing in creating prestigious names would rise.”<sup>42</sup> This argument requires some unpacking. One must compare three states of the world:

- (1) unauthorized free-riding is allowed and occurs.
- (2) unauthorized free-riding is forbidden and no licensing occurs.
- (3) unauthorized free-riding is forbidden, but licensing occurs.

The incentive to invest in the creation of prestigious names is the same in states (1) and (2). Although free-riding occurs in state (1), that does not mean there is less incentive to invest than in (2). By hypothesis, the trademark owner is not harmed by the unlicensed use. That is, the market for the trademark owner’s product is unaffected by the unlicensed use. The unlicensed user benefits from the trademark owner’s investment, but that benefit in no way reduces the owner’s incentive to invest.

On the other hand, the incentive to invest in the creation of prestigious names is higher in state (3). In this situation, investment benefits the trademark owner in two ways: sales of the trademark owner’s product and licensing revenue. Since the creator of a famous trademark stands to gain more, the incentive to invest is larger.

Whether there will actually be an increase in incentives to create famous trademarks will thus depend on the extent of licensing. If, as conjectured above, trademark owners are unlikely to license non-competing, unrelated uses, then forbidding unauthorized free-riding will not increase incentives to create famous marks. All that will happen is that we will move from state of the world (1) – lots of unauthorized free riding—to state of the world (2) – no authorized or unauthorized free riding. On the other hand, if there were some licensing – state of the world (3) – forbidding free-riding could increase investment. Even here, however, Landes and Posner argue that competition among famous trademark owners would drive licensing revenue to zero, so even state of the world (3) would not result in any increased incentive to invest.<sup>43</sup> Thus, the only way forbidding free riding could increase investment is if only a small number of owners of famous marks were willing to license. With only a small number of famous marks available for license, competition might not drive licensing revenue to zero and mandating licensing for otherwise free-riding uses could generate some revenue. On the other hand, since only a small fraction of famous trademark owners would be taking advantage of this opportunity, the overall *ex ante* incentive effects would be small.

In addition, even if there were some incentive effects, it is unclear whether there is any need for increased incentive to create famous names. The profits from selling prestigious products seem sufficient, and it unclear what social benefit there would be from additional incentives. In fact, to the extent that prestigious products are used to signal their consumers’ wealth, it might be socially desirable to reduce investment in famous brands. Displays of wealth, like arms races, may benefit no one. To the extent

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<sup>42</sup> *Economic Structure*, supra note \_\_, at 207-8.

<sup>43</sup> *Id.* at 208. Landes & Posner also argue that forbidding free riding could help trademark owners inefficiently prevent their marks from becoming generic. *Id.* This seems unlikely. Non-confusing uses by non-competitors are not the kinds of uses that are likely to cause genericness. A restaurant called Tiffany’s is not likely to make consumers think that “Tiffany’s” is generic for jewelry or jewelry store.

that people are concerned primarily about their wealth relative to others, displays of wealth are a zero-sum game. One person's spending advances her own status at the expense of someone else's. As a result, overall welfare might be higher if everyone were prevented from spending to display wealth.<sup>44</sup> Of course, refusing to recognize free-riding as a form or theory of dilution would not prevent most displays of wealth. Nevertheless, to the extent that doing so would reduce investment in prestigious marks, it might reduce the social loss that such displays cause. In any event, consideration of wealth signaling casts doubt on the argument that increased investment in prestigious names would be socially valuable.

It is interesting to note that the case which led the Fourth Circuit to the “actual harm” requirement, and thus created the circuit split which prompted Supreme Court review of *Victor's Little Secret*, seems to have involved pure free riding. The plaintiff in that case presented survey evidence that consumers seeing Utah's tourism slogan, “greatest snow on earth” thought of The Ringling Brothers' Circus and its slogan, “the greatest show on earth.” Justice Stevens analyzed the case as follows:

We do agree, however, with that court's conclusion that, at least where the marks at issue are not identical, the mere fact that consumers mentally associate the junior user's mark with a famous mark is not sufficient to establish actionable dilution. As the facts of that case demonstrate, such mental association will not necessarily reduce the capacity of the famous mark to identify the goods of its owner, the statutory requirement for dilution under the FTDA. For even though Utah drivers may be reminded of the circus when they see a license plate referring to the "greatest snow on earth," it by no means follows that they will associate "the greatest show on earth" with skiing or snow sports, or associate it less strongly or exclusively with the circus. "Blurring" is not a necessary consequence of mental association. (Nor, for that matter, is "tarnishing.")

The Ringling Brothers' survey established free riding. Consumers who saw the defendant's slogan, “greatest snow on earth,” thought of the Ringling Brothers' Circus and its slogan. Utah, in its attempt to promote tourism, was attempting to link its snow with the favorable associations generated by the famous circus. Nevertheless, there was no evidence of blurring or tarnishment. The Fourth Circuit therefore held that there was no dilution, and Justice Stevens' opinion endorsed that finding. Thus, where there is only free riding, both Justice Stevens' opinion, and the analysis provided here, suggest that there is no actionable harm.

## VI. Conclusion

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<sup>44</sup> Robert Frank, *Choosing the Right Pond: Human Behavior and the Quest for Status* (1985); Daniel Klerman, “The Expressive Function of Trademarks” (unpublished manuscript, 1999); Jonathan Barnett, “Shopping for Gucci on Canal Street: Reflections on Status Consumption, Intellectual Property and the Incentive Thesis,” \_ Virginia Law Review \_\_ (forthcoming).

Justice Stevens's opinion in *Victor's Little Secret* highlights the need to identify the actual harm caused by dilution. That is not an easy task. There is some evidence that blurring increases search costs, although more work needs to be done. In addition, even if blurring and other forms of dilution cause actual harm, without relaxation of the naked licensing doctrine, anti-dilution law may cause even more harm, by preventing socially beneficial licensing deals.