

THE LINGUISTIC AND TRUST FUNCTIONS OF TRADEMARKS: LAW AND ECONOMICS PERSPECTIVE

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In 1987 William Landes and Richard Posner influentially presented a “search costs” theory of trademark laws. This theory identifies two primary benefits of trademark and their legal protection. First, trademarks reduce consumer search costs by providing a concise and unequivocal identifier of the particular source of particular goods, thus facilitating the exchange between buyers and sellers. Trademarks also provides producers an incentive to maintain their goods and services at defined and persistent qualities, which in turn further reduces search costs by allowing consumers to rely on the trademarks as mental shortcuts when making purchasing decisions.

While the benefits from reducing search costs are quite straightforward, in the sense that *ceteris paribus*, simplicity is preferable over complexity, and lower costs are preferable to higher, this paper will elaborate on the second benefit of trademark protection, the incentive to provide quality. The paper will argue that in fact, we can identify a broader and distinct benefit, which is sometimes implied in the conventional economic analysis of trademarks, but deserves greater prominence. It will show that trademarks not only improve markets’ efficiency by reducing search costs, but in many cases are essential for their very existence.

The gist of the argument is that in many cases various attributes of goods are known to the sellers but cannot be observed or verified by consumers. Because of this information asymmetry, sellers have an incentive to mischaracterize their goods as carrying desirable attributes and to conceal their undesirable ones. Consumers, aware of this incentive and of their inability to distinguish between honest and dishonest sellers, respond by discounting the quality claims made by all sellers. This may result in a market failure, first identified by George Akerlof, and has since been known as “the market for lemons”.

Trademark law plays an important role in addressing this potential market failure. In the case of experience goods, sellers interested in generating repeat sales will have an incentive to supply and maintain the quality that they promise. Trademark law assists them not only in reducing search costs but in preventing other competitors from passing themselves off as the honest ones, as described above. Repeat sales may not solve the problem with respect of credence goods or credence attributes, since these, by definition, cannot be verified by the consumer. However, trademark law still plays a role in these circumstances. For example, certification marks allow consumers to rely on quality assurances supplied by third parties (e.g., Fair Trade labels). Geographical indications sometimes perform a similar function. Therefore, trademark law is important in a more fundamental way than merely reducing search costs. In the not infrequent cases where the

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information available to sellers and consumers about various attributes of goods and services is asymmetric, trademark law may be essential for markets to exist.

We can summarize this by highlighting that trademarks and the legal protection thereof perform two distinct functions: they reduce search costs by condensing complex meanings into concise and unequivocal terms, *and* they allow buyers to trust and rely upon the signals conveyed by sellers, thus preventing lemonization of markets with information asymmetry. The paper will call the first function the linguistic function of trademarks, and the second, the trust function of trademarks.

This distinction between the linguistic and trust functions of trademarks provides a normative gauge for various rules or doctrines of trademark law. The paper will show that rules and doctrines that are consistent with both functions (whether by prohibiting certain uses of marks or permitting them) are normatively robust. Rules and doctrines that are inconsistent with both functions are normatively weak, and rules and doctrines that are consistent with one but not the other deserve much closer cost-benefit analysis. For example, confusing uses of marks upset both functions and therefore rules prohibiting them are normatively robust. Unauthorized uses of marks for comparative advertising do not upset either function (and at times may actually promote them). Therefore, the law in jurisdictions that restrict such uses is normatively weak. Finally, rules against dilution or against “initial interest confusion” may, in some limited cases, be justified to protect the linguistic function of trademark but will generally have nothing to do with the trust function. Therefore these rules are only moderately justified, depending on a more detailed cost benefits analysis.