

Brand Spillovers
By Eric Goldman *

INTRODUCTION.

Jane sees a drugstore advertisement for Tylenol at a very cheap price, so Jane decides to visit the drugstore. When she gets to the pain reliever aisle, she notices that the retailer is offering (on the same shelf as Tylenol but to its immediate right) a “generic” version of Tylenol at an even cheaper price. Jane decides to buy the generic version instead. On the way to the cash register, Jane also notices a prominent display at the aisle end for her preferred brand of shampoo, so she picks up a bottle of shampoo as well. In the end, Jane went to the store looking for Tylenol, she left the drugstore a satisfied consumer even though she did not buy Tylenol.

Jane’s story should sound familiar; millions of consumers every day have similar experiences. Her choices are not purely serendipitous. Instead, the drugstore deployed several merchandising tricks to induce Jane to make her purchase decisions to increase the drugstore’s profits from Jane’s visit. Jane and the drugstore both may be happy with the outcome, but what about McNeil PPC, Tylenol’s maker? McNeil PPC spent millions of dollars to build a well-known brand that was strong enough to draw Jane to the drugstore, but in the end the drugstore and other manufacturers profited from Jane’s visit and McNeil PPC got nothing. Is this right? Or fair?

This Article discusses “brand spillovers,” which occur when a trademark owner creates value for third parties but does not get compensated for this value.¹ In Jane’s situation, the drugstore deliberately created brand spillovers for its profit, and other manufacturers got economic benefits too. In fact, retailers routinely profit from brand spillovers, and they have done so for decades. And, for the most part, everyone (including, conspicuously, trademark owners) either was blissfully unaware of brand spillovers or tacitly tolerated them.

However, with the emergence of online intermediaries like search engines, brand spillovers have become one of the hottest, and most analytically challenging, issues in trademark law.

Joe has a headache and wants to find out where he can buy some Tylenol. He enters the search term “Tylenol” into the Google search engine. Along with his search results, Google displays an ad for a third party competitor’s analgesic because the competitor bought the keyword “Tylenol” from Google.² Joe clicks on the ad, learns that the competitive analgesic will meet his needs at a lower cost, and ultimately buys the competitive product.

As with Jane’s scenario, Google used Joe’s interest in a third party trademark to create a profit-enhancing brand spillover. Yet, unlike the drugstore in Jane’s situation, trademark

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¹ Brand spillovers are a subset of economic spillovers generally (also called externalities by economists).

² This scenario is fictional. On August 16, 2007, I searched for the term “Tylenol” in Google and, surprisingly, saw no ads at all.

owners have taken a keen interest in brand spillovers online. Google and other intermediaries have been sued numerous times for selling keyword advertising, and two states have passed laws restricting such advertising. However, these developments have not helped clarify the legal situation. Instead, the legality of keyword advertising has sunk into a doctrinal morass, and there is no clear path to resolve the wildly divergent views on its legitimacy.

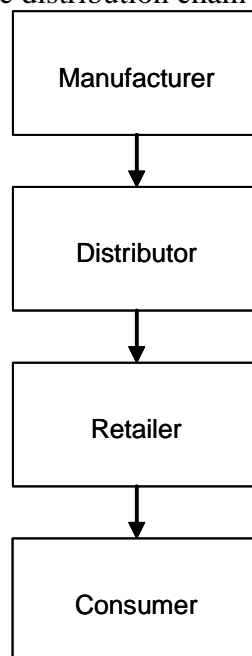
This Article proposes one possible path to resolution. Drawing from our decades-long experience with retailers and brand spillovers, Part I of this Article explains how retailers add value as intermediaries by lowering consumer search costs, including in some cases creating brand spillovers for profit. In Part II, the Article shows that online intermediaries are becoming the new retailers online. In that capacity they, too, create brand spillovers as part of their intermediation. Part III suggests that retailers and online intermediaries have been subject to different legal standards for their brand spillover activities because of cyberspace exceptionalism. Part III concludes by arguing that retailers and online intermediaries equally should be permitted to use brand spillovers as part of their intermediation efforts to reduce consumer search costs.

I. RETAILERS AND TRADEMARK LAW.

This Part explains how retailers create brand spillovers that increase retailer profits. Yet, despite this seeming misappropriation of manufacturer goodwill, retailers escape trademark law consequences for these brand spillovers.

A. Retailers as Active Intermediaries.

A typical consumer product reaches consumers via a four stage process: (1) manufacturer makes the good, (2) manufacturer sells the good to distributors (there may be several levels of distributors in the chain), (3) distributors sell the good to retailers, and (4) retailers sell the good to end users/consumers.³ Visually, the distribution chain looks like this:



³ Naturally, this typical model has many variations, such as manufacturers who sell direct to consumers.

Traditionally, neo-classical economists ignore retailers in this distribution chain.⁴ These believe that retailers simply passively mediate between consumers and manufacturers, accurately aggregating consumer demand for products and communicating that information “up the chain” to manufacturers. Their argument is that if a retailer did anything else, that retailer would not satisfy consumer demand while other retailers would, driving the nonconforming retailer out of business. As a result, these economists can ignore the retailers’ presence in the chain because they simply act as a pass-through for consumer preferences.

Unfortunately, this assumption is wrong. Retailers actively mediate the manufacturer-consumer relationship to maximize their own profits.⁵ Retailers’ profit-maximizing choices can significantly affect the economic mechanisms that transmit consumer demand to manufacturers.

On the supply side, retailers prevent manufacturers from maximizing all profitable sales. First, retailers may not even carry a manufacturer’s goods at all. For example, in the grocery context, retailers typically have space to carry only a small fraction of the new products introduced each year by manufacturers.⁶ In fact, if a retailer allocates only enough space to carry a single manufacturer’s goods, the retailer’s decision creates a “winner-take-all” effect,⁷ leaving other manufacturers without a distribution channel for incrementally profitable sales. Because retailers’ decisions can have such significant effects on manufacturer profits, manufacturers may gladly pay retailers to sway placement decisions.⁸

Even when retailers carry a manufacturer’s goods, retailers seek to maximize their overall profit from each consumer.⁹ As a result, retailers do not care which manufacturer gets the sale if each manufacturer offers the same margin to the retailer; and when there are differences in margins between manufacturers, retailers want consumers to pick the goods from the manufacturer offering them the highest margin. Retailers may try to “fire” customers who are unprofitable to them,¹⁰ even if those customers would have created profitable sales for manufacturers. As a result, based on retailers’ own efforts to maximize profits, retailers generally do not attempt to maximize any individual manufacturer’s sales or profits.

⁴ See, e.g., Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J. L. & ECON. ____ (2007); Michael P. Lynch, *Why Economists Are Wrong to Neglect Retailing and How Steiner’s Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911 (2004) (“economists believe that retailing can be acceptably modeled as a perfectly competitive industry with constant marginal costs”).

Economists also ignore distributors. For simplicity, I do so as well because the ways distributors add value in the chain can vary widely by industry. However, because distributors mediate the relationship between retailers and manufacturers, distributors could have the same profit-motivated biasing effect that this Article ascribes to retailers.

⁵ See, e.g., Michael P. Lynch, *Why Economists Are Wrong to Neglect Retailing and How Steiner’s Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911 (2004).

⁶ See, e.g., Vithala R. Rao & Edward W. McLaughlin, *Modeling the Decision to Add New Products by Channel Intermediaries*, 53 J. MARKETING 80 (1989); FMI Backgrounder, *Slotting Allowances in the Supermarket Industry*, <http://www.fmi.org/media/bg/slottingfees2002.pdf>. [CITE]

⁷ See Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits,”* 12 GEO. MASON L. REV. 119 (2003).

⁸ See generally Marianne M. Jennings et al., *The Economics, Ethics and Legalities of Slotting Fees and Other Allowances in Retail Markets*, 21 J. L. COMMERCE 1 (2001) (describing the variety of ways that retailers extract concessions from manufacturers).

⁹ See, e.g., Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits,”* 12 GEO. MASON L. REV. 119 (2003).

¹⁰ See, e.g., LARRY SELDEN & GEOFFREY COLVIN, *ANGEL CUSTOMERS & DEMON CUSTOMERS* (2003).

On the demand side, retailers do not just passively reflect consumer demand but routinely generate and redirect it for their profit.¹¹ Typically, retailers carefully and scientifically design their stores to accomplish the singular goal of extracting more money from consumer pockets.¹² For example, sales increase as consumers spend more time in a store,¹³ so groceries deliberately try to increase in-store time through a variety of tricks, such as placing staple items (e.g., milk, eggs, bread) designed to get consumers to walk through the entire store seeking these items and see other items along the way.¹⁴ Groceries induce consumers to make unplanned/“impulse” purchases by putting high-margin items at the checkout stand (when consumers have their wallets out) or kid-appealing items on lower shelves (where kids are more likely to see them).¹⁵

Retailers also shape consumer demand due to their control over the “point-of-purchase” consumer experience. Most obviously, retailers determine the final price charged to consumers.¹⁶ To the extent price signals quality,¹⁷ retailer-determined pricing can affect consumer perceptions, especially when retailers aggressively price-discount a good.¹⁸ Similarly, retailers can communicate information about product relationships to consumers by creating product bundles, such as “buy cereal, get bananas free.”

Retailers’ product placement decisions also affect consumer demand. Retailers decide if they want to carry a good at all; and if they do, where to place it within their store—both at a category level within the retailer’s “taxonomy” of products, as well as the shelf within that product category. A retailer’s shelf-by-shelf product configuration plan, reflecting its various merchandising decisions, is called a “plan-o-gram.”¹⁹

¹¹ See Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1444-50 (1999); Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J. L. & ECON. ____ (2007) (“Retailers are not passive transmitters of exogenous consumer demand, but also create consumer demand for a product by displaying it on their shelves.”).

¹² See Jack Hitt, *The Theory of Supermarkets*, N.Y. TIMES, March 10, 1996 at 56 (“each inch of [grocers’] space is scientifically calibrated to hold only what you will buy at the highest possible margin”).

¹³ See PACO UNDERHILL, WHY WE BUY 33, 37 & 102 (1999); Jack Hitt, *The Theory of Supermarkets*, N.Y. TIMES, March 10, 1996 at 56 (each minute in a supermarket above the average generates an additional \$1.89 of sales).

¹⁴ See PACO UNDERHILL, WHY WE BUY 82 (1999); Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1447 (1999). Another example: drug stores position their pharmacy department at the back of their stores to get consumers to walk through the entire store. See PACO UNDERHILL, WHY WE BUY 82-83 (1999).

¹⁵ See Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1446-50 (1999). See also PACO UNDERHILL, WHY WE BUY 18-19 (1999) (stocking pet food treats on lower shelves because kids were principal decision-maker for treat purchases).

¹⁶ Manufacturers exercise some indirect control over consumer prices by setting the manufacturer’s wholesale prices. Further, manufacturers can try to exercise control over retailer pricing through minimum price obligations. See, e.g. *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, ___ U.S. ___ (2007). Even in those cases, however, the retailer controls the final pricing determination.

¹⁷ See, e.g., Paul Milgrom & John Roberts, *Price and Advertising Signals of Product Quality*, 94 J. POL. ECON. 796 (1986).

¹⁸ For this reason, manufacturers have repeatedly sought legal mechanisms to restrict unwanted retailer price discounting, including (most notably) the Fair Trade Acts. [CITE]

¹⁹ See, e.g., *Uniek, Inc. v. Dollar General Corp.*, 2007 WL 1795505, *1 (W.D. Wis. 2007) (“A planogram is “a diagram of fixtures and products that illustrates how and where retail products should be displayed, usually on a store shelf in order to increase customer purchases”; it assigns a “specific amount of space ... to specific items in the store.”); *Posely v. Eckerd Corp.*, 433 F. Supp. 2d 1287, 1294 (S.D. Fla. 2006).

While retailers generally control their plan-o-grams, manufacturers may help retailers develop plan-o-grams.²⁰ Sometimes, retailers solicit placement advice from manufacturers; in other cases, retailers designate a manufacturer as the “category captain” to lay out the retailer’s entire product category—including placement of the captain’s competitors’ products.²¹ Even in these cases, retailers retain final decision-making authority,²² including the ultimate authority to simply stop carrying a manufacturer’s goods.²³

Retail shelf placement affects consumer demand because it acts as advertising for the product. According to retail anthropologist Paco Underhill, “[a]bout 60 to 70 percent of the things we buy in supermarkets and convenience stores we had no intention of buying when we walked in the door,”²⁴ and shelf placement can educate new consumers about the product’s availability and remind existing consumers to consider the product.²⁵ In some cases, such as products with limited advertising options (like cigarettes), shelf placement can be an essential form of advertising.²⁶ In all cases, shelf placement can stimulate impulse purchases, and better shelf placement may produce more impulse purchases.²⁷ In contrast, sales for a manufacturer’s goods will suffer if a retailer stocks it in poor-quality (i.e., poorly visible) selling spaces, such as space at the back of the store or too high/low on shelves.²⁸ Therefore, retailer placement decisions directly affect consumer demand for manufacturers’ products.

²⁰ Manufacturers may also provide the physical display units at their expense. *See, e.g.*, *Western Publishing Co. v. Publications Int’l, Ltd.*, 1995 WL 1684082, *5 (N.D. Ill. 1995).

²¹ *See* Robert L. Steiner, *Category Management—A Pervasive, New Vertical/ Horizontal Format*, ANTITRUST, Spring 2001, at 77; Leo S. Carameli, Jr., Note, *Anti-Competitive Effects and Antitrust Implications of Category Management and Category Captains of Consumer Products*, 79 CHICAGO-KENT L. REV. 1313 (2004). *See also* *Conwood Co., L.P. v. U.S. Tobacco Co.*, 290 F.3d 768, 775 (6th Cir. 2002); *Uniek, Inc. v. Dollar General Corp.*, 2007 WL 1795505 (W.D. Wis. 2007).

²² *See* *Conwood Co., L.P. v. U.S. Tobacco Co.*, 290 F.3d 768, 785 (6th Cir. 2002) (even when outsourcing category management, retailers had the final decision); *Bristol-Myers Squibb Co. v. McNeil-P.P.C., Inc.*, 786 F. Supp. 182 (E.D.N.Y. 1992), *rev’d on other grounds*, 973 F.2d 1033 (2d Cir. 1992) (“Despite McNeil’s assertions that it provides a planogram to each of its retailers—a claim which the Court readily finds credible—it has little if any ability to control and monitor the placement of TYLENOL PM on a daily basis.”); *R.C. Bigelow, Inc. v. Unilever N.V.* 689 F. Supp. 76, 81 (D. Conn. 1988), *rev’d on other grounds*, 867 F.2d 102 (2d Cir. 1989) (“defendants have submitted an affidavit by Zip Lemmerman, Senior Vice President, Merchandising, for Pathmark Supermarkets, in which Mr. Lemmerman states that “it is Pathmark, and not Lipton or any other supplier, which decides shelf location and how much space each product will receive in the allocation”).

²³ *See* *Uniek, Inc. v. Dollar General Corp.*, 2007 WL 1795505 (W.D. Wis. 2007) (manufacturer lawsuit after being dropped as exclusive supplier to retailer).

²⁴ Quoted in David Segal, *Philip Morris, Leader of the Packs Cigarette Maker's Rivals Sue Over Display Racks*, WASH. POST, Sept. 15, 1999, at E1. *See also* Jack Hitt, *The Theory of Supermarkets*, N.Y. TIMES, March 10, 1996 at 56 (only 1/3 of consumers’ supermarket purchases are planned; the remainder are “splurchases”).

²⁵ *See generally* Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits,”* 12 GEO. MASON L. REV. 119 (2003) (discussing placement as a type of “promotional services” provided by retailers); FMI Backgrounder, *Slotting Allowances in the Supermarket Industry*, <http://www.fmi.org/media/bg/slottingfees2002.pdf> (manufacturers have reduced mass media marketing spends and redirected those dollars to convincing grocers to give more prominent in-store promotion; due to consumer infoglut, “consumers can be reached most effectively in the stores where they actually buy groceries”).

²⁶ *See* David Segal, *Philip Morris, Leader of the Packs Cigarette Maker's Rivals Sue Over Display Racks*, WASH. POST, Sept. 15, 1999, at E1. Also, as fewer consumers see television commercials, shelf-based advertising becomes even more important. *See* Louise Story, *Product Packages Now Shout to Get Your Attention*, N.Y. TIMES, Aug. 10, 2007.

²⁷ *See, e.g.*, PACO UNDERHILL, *WHY WE BUY* 79 (1999) (discussing the value of endcaps).

²⁸ *See* PACO UNDERHILL, *WHY WE BUY* 80-81 (1999); PACO UNDERHILL, *WHY WE BUY* 84 (1999) (“the rear wall is a dead zone”).

These placement decisions may also indirectly affect consumer demand by shaping consumer brand perceptions. Placement choices may cause consumers may make inferences about the product's importance and meaning.²⁹ For example, a bookstore's decision to prominently display a book (such as near the high-traffic front of the store) can lead potential readers to infer that the book is popular and being widely read.³⁰ Further, retailers' decisions about how to categorize products in their taxonomy communicates some valuable information to consumers about the nature of the product. For example, a grocer's merchandising decision to place apples in the cheese aisle might prompt some consumers to create an association between the two products.

As this discussion suggests, retailers make decisions about the consumer experience that bear a striking resemblance to editorial judgments made by traditional media entities. A newspaper publisher selects an editorial focus and then decides what items to publish, how much space to allocate to those items, and where to place those items in the publication, and collectively those decisions communicate the publisher's editorial message. Similarly, a retailer selects a grouping of products to offer and then decides what items to carry, how much space to allocate to those items, and where to place those items within its store, and collectively those decisions affect consumer demand.

Of course, retailers and traditional media differ in one fundamental way: retailers make their "editorial judgments" based on profit-maximization,³¹ while the traditional media's editorial judgments are theoretically untainted.³² Nevertheless, both retailers and traditional media entities act as intermediaries, and their intermediation has similar effects on their customers. Accordingly, we might reconceptualize retailers as editors and retailers' merchandising decisions as a subset of editorial judgments generally.

B. Retailers Avoid Trademark Liability for Performing Their Editorial Functions.

Trademark law governs many aspects of retailing. Retailers create their own trademarks for their goods and services,³³ so they face trademark liability when they market their own goods or services using a brand that is too close to someone else's.³⁴ In particular, "house brands"—retailer-branded versions of highly advertised third party branded products³⁵—may create trade

²⁹ See PACO UNDERHILL, *WHY WE BUY* 202 (1999) (product juxtapositions educate consumers). Cf. Christina L. Brown & Aradhna Krishna, *The Skeptical Shopper: A Metacognitive Account for the Effects of Default Options on Choice*, 31 J. CONSUMER RESEARCH 529 (2004) (discussing how marketers' merchandising decisions communicate information to consumers).

³⁰ See Randy Kennedy, *Cash Up Front*, N.Y. TIMES, June 5, 2005, §7. See also PACO UNDERHILL, *WHY WE BUY* 91 (1999) (Blockbuster was encouraged to deliberately "spike" the trolley of returned videos with old movies as a way of "making them seem current and desirable," in turn alleviating demand for scarce copies of new releases).

³¹ See Randy Kennedy, *Cash Up Front*, N.Y. TIMES, June 5, 2005, §7.

³² See, e.g., C. EDWIN BAKER, *ADVERTISING AND A DEMOCRATIC PRESS* 83 (1994).

³³ See 2 J. THOMAS MCCARTHY, *MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION* § 16:47 (June 2007).

³⁴ See, e.g., *Grocery Outlet Inc. v. Albertson's Inc.*, 2007 WL 2264702 (9th Cir. 2007). [CITE]

³⁵ House brands are a retailer's proprietary branded product, often meant to compete with a well-known third party manufacturer's brand. Other names for house brands include "store brands," "private label brands" and "own brands."

dress or trademark problems.³⁶ Retailers also may be liable for carrying and reselling third party infringing goods.³⁷

However, the typical manufacturer-vs.-manufacturer trademark infringement lawsuit effectively ignores retailers—even when the retailers, not the defendant manufacturers, are responsible for the actions that might contribute to consumer confusion. For example, some courts consider the adjacency of manufacturers' goods in retail stores as a likelihood of consumer confusion factor—even when retailers, not manufacturers, made the adjacency decisions.³⁸ In another case, involving similarly branded cigarettes and alcohol (both including the word “Death” in their mark) from different manufacturers, the court said that the fact retailers sometimes bundled these two products into a single-price package indicated that the goods catered to similar customer bases—even though the retailers had unilaterally created the bundle without permission from either trademark owner.³⁹ In almost all of these cases, retailers are left on the sidelines both by the plaintiff and the judge.⁴⁰

Similarly, judges and plaintiffs also typically ignore retailers' deliberate activities to create and profit from brand spillovers. Consider some of the ways that retailers “merchandise” their products to capitalize on consumer interest in third party brands and thereby increase their own profits:⁴¹

Loss Leaders. To stimulate consumer traffic to the retailer's store, retailers often prominently advertise a well-known branded product at a significant discount (a “loss leader”).⁴² The retailer expects that once consumers get into the store seeking the loss leader, many of them will purchase a basket of products that collectively generate profit for the retailer. In effect, retailers use the trademarked loss leader to stimulate profitable sales of third party manufacturers' products.

Shelf Space Adjacency. As part of a retailer's categorization, the retailer typically places related products from multiple manufacturers into a physically adjacent group. This adjacency inevitably creates brand spillovers among the products.⁴³ Consumers may come into the store

³⁶ See Jean-Noël Kapferer, *Brand Confusion: Empirical Study of a Legal Concept*, 12 PSYCH. & MARKETING 551 (1995).

³⁷ Trademark infringement is a strict liability claim, so a retailer's scienter is irrelevant. See 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 25.57.

³⁸ See, e.g., *In re Martin's Famous Pastry Shoppe*, 748 F.2d 1565 (Fed. Cir. 1984). In this case, the senior user had a registration for cheese, and the junior user appealed a registration denial for bread. In affirming the denial, the Federal Circuit noted that the Trademark Trial and Appeal Board could consider that “deli counters may well display bread and rolls in close proximity to the cold cuts and cheeses purveyed there.” *Id.* at 1567. As a result, retailers' merchandising decisions were held against the defendant-manufacturer. [Post list of cases]

³⁹ See *Death Tobacco Inc. v. Black Death USA*, 31 U.S.P.Q. 2d 1899 (C.D. Cal. 1993). See also *Storck USA v. Farley Candy Co.*, 797 F. Supp. 1399, 1411 n.13 (N.D. Ill. 1992) (court ignores testimony that sometimes retailers break apart a manufacturer's packaging to sell candy items individually).

⁴⁰ As rare examples of courts acknowledging retailer placement decisions, see *Gray v. Meijer, Inc.*, 295 F.3d 641 (6th Cir. 2002); *McNeil-PPC, Inc. v. Guardian Drug Co., Inc.*, 984 F. Supp. 1066, 1072 (E.D. Mich. 1997) (in a case against a retailer's house brand, the court notes that the retailer-defendant, “as the store owner, no doubt is responsible for the decision to locate the products side-by-side on the shelf”).

⁴¹ See generally Benjamin Klein, *Exclusive Dealing as Competition for Distribution “On the Merits,”* 12 GEO. MASON L. REV. 119 (2003) (discussing how retailers can free-ride on manufacturer investments).

⁴² See AMERICAN HERITAGE® DICTIONARY OF THE ENGLISH LANGUAGE (Fourth Edition 2000), <http://www.bartleby.com/61/53/L0255300.html>.

⁴³ See PACO UNDERHILL, *WHY WE BUY* 89 (1999) (“everyone knows that adjacencies are of huge importance to every product...Great retail minds churn themselves into mush trying to unravel the mysteries of which products should be sold near one another for maximum spark and synergy.”).

looking for brand X but, seeing competitive or complementary brands in physical proximity, may make unplanned/impulse decisions to choose brand Y instead (or as well).⁴⁴ In these cases, brand Y gets a positive spillover from brand X.⁴⁵

Retailers can deliberately take advantage of these inevitable spillovers to increase their profits. When profit margins for adjacent products are about the same, adjacency-caused spillovers are profit-neutral to the retailer. However, retailers can deliberately position a high-margin item next to a low-margin item with the hopes that some consumers pick the high-margin item as an alternative.⁴⁶ For example, retailers generally make more profits from house brands than heavily promoted third party branded products.⁴⁷ Therefore, when retailers put house brands adjacent to heavily promoted brands,⁴⁸ retailers are trying to get consumers to pick the house brand and thereby increase the retailer's profits.⁴⁹

Pre- and Post-Sale Merchandising. Retailers may use a consumer's expressed interest in a trademark to merchandise other goods and services to them.

Pre-sale, a retailer may explicitly redirect a consumer in response to the consumer's expressed brand preferences. For example, a consumer request a specific brand that the retailer does not carry, and the retailer may suggest alternatives that are in stock. Or, a consumer may request a branded product that the retailer carries, but a retail salesperson may try to sell an alternative brand (such as one paying a larger commission to the salesperson).⁵⁰

Retailers can place high-demand prominent brands (i.e., ones that consumers are willing to seek out) in locations within the store to move customers to desired spots. For example, retailers can place popular brands further back in the store as a way of drawing consumers through a store, where they will be exposed to more merchandise from other manufacturers.⁵¹

Post-sale, retailers may merchandise products based on the consumer's purchase of specific brands. For example, retailers can use Catalina Marketing's post-purchase coupon system⁵² to sell the right to print coupons for third party competitive products triggered by a consumer's

⁴⁴ See PACO UNDERHILL, *WHY WE BUY* 201 (1999).

⁴⁵ See *Kendall-Jackson Winery, Ltd. v. Superior Court ex rel E&J Gallo Winery*, 76 Cal. App. 4th 970, 976 (Cal. App. Ct. 1999) (Gallo's sales representatives design retailers' plan-o-grams "to place an inferior, lower priced Gallo product adjacent to a higher priced category leader. The category leader's display attracts the consumer's attention. When the consumer reaches for the well-known product, he or she will see the lower priced Gallo product, and may buy that product instead.").

⁴⁶ See Benjamin Klein, *Exclusive Dealing as Competition for Distribution "On the Merits,"* 12 GEO. MASON L. REV. 119 (2003)

⁴⁷ See Michael P. Lynch, *Why Economists Are Wrong to Neglect Retailing and How Steiner's Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911 (2004) ("retailers choose relatively low margins on leading nationally advertised brands compared to lesser brands and store brands...the more prominent the brand, the lower its retail margin"); *Brand Name Food Items Find Stiff Competition from In-House Products*, FOOD & DRINK WEEKLY, July 28, 2003.

⁴⁸ In fact, the prominent brand should go directly at eye-level and the spillover-driven brand should go to its immediate right. See PACO UNDERHILL, *WHY WE BUY* 77-78, 204 (1999).

⁴⁹ See Jean-Noël Kapferer, *Brand Confusion: Empirical Study of a Legal Concept*, 12 PSYCH. & MARKETING 551, 552 (1995).

⁵⁰ See Benjamin Klein, *Exclusive Dealing as Competition for Distribution "On the Merits,"* 12 GEO. MASON L. REV. 119 (2003). A retailer's false promotion of the branded product might be "bait and switch," but it is not a 43(a) violation. See *Norton Tire Co. v. Tire Kingdom Co.*, 858 F.2d 1533 (11th Cir. 1988).

⁵¹ See PACO UNDERHILL, *WHY WE BUY* 82 (1999) (retailers want to position popular brands in the middle of aisles to draw consumers down the aisles and be exposed to other products; manufacturers prefer to be at the end of aisles).

⁵² <http://www.catalinamarketing.com/CCM/index.asp>.

actual grocery purchases. As another example, Amazon.com suggests that consumers buy new books (from third party publishers) based on the consumer's past purchases.

Store Clustering. Retailers can produce brand spillovers by physically locating their stores adjacent to a popular destination store.⁵³ For example, malls use “anchor tenants” (typically, stores with big marketing budgets or a strong brand) to bring in traffic that spills over to other tenants.⁵⁴ As another example, competitive retailers—such as car dealers or gas stations—may cluster together to take advantage of each other's overflow traffic.⁵⁵ In some cases, a free-riding retailer can reduce their marketing spend if an adjacent retailer will bring in customers anyway.

Trademark Law Ignores Brand Spillovers

Retailers may face trademark liability if they engage in store shelf adjacency⁵⁶ or store clustering⁵⁷ using confusingly similar packaging. Otherwise, my research suggests that retailers do not commit trademark infringement solely for capitalizing on brand spillovers. To the extent that courts discuss retailers engaging in profit-enhancing brand spillover activities (which is rare), they have generally held or suggested that such retailer activities do not constitute trademark infringement. For example, a few cases have said that retailers' profiting from store shelf adjacency (without more) does not infringe trademarks.⁵⁸ Cases have also endorsed

⁵³ See generally Charles Q. Choi, *Atomic Physics Predicts Successful Store Locations*, LIVESCIENCE, Sept. 27, 2006 (proximity of complementary stores increases odds of a new business' success).

⁵⁴ See Malcolm Gladwell, *The Terrazzo Jungle*, NEW YORKER, Mar. 15, 2004, at 120, 123 (“The point of a mall—the reason so many stores are clustered together in one building—is to allow smaller, less powerful retailers to share in” traffic generated by department stores). Note that the mall operator often also benefits from optimizing the tenant mix, both from increased rents and from the mall operator's share of tenants' gross receipts.

⁵⁵ See *Gallo Motor Center Corp. v. Mazda Motor of Am.*, 204 F. Supp. 2d 144, 153 (D. Mass. 2002); *Northside Lincoln Mercury, Inc. v. Ford Motor Co.*, 603 F. Supp. 2, 5 (D. Minn. 1983).

Clustering can produce negative spillovers. For example, a retailer may not want to locate next to a bank because people walk past banks quickly, reducing the chance that passing consumers will see the retailer's window display. See PACO UNDERHILL, *WHY WE BUY* 76 (1999).

⁵⁶ For example, a retailer's house brand may too closely resemble the national brand, supporting a trademark infringement claim. See J. THOMAS MCCARTHY, *MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION* § 23:53 (June 2007); *McNeil-PPC, Inc. v. Guardian Drug Co., Inc.*, 984 F. Supp. 1066 (E.D. Mich. 1997) (retailer's house branded digestive aid too similar to branded competitor).

⁵⁷ For example, numerous pre-Lanham Act cases found unfair competition when a new store would open next to existing store and adopt a similar name/trade dress designed to divert the original store's customers. See, e.g., *Weinstock, Lubin & Co. v. Marks*, 109 Cal. 529 (1895); *Lichenstein v. Levin*, 27 Ohio N.P. (N.S.) 337 (Ohio Ct. Common Pleas 1927).

For a more recent example, see *Toy Manufacturers of America v. Helmsley-Spear, Inc.*, 960 F. Supp. 673 (S.D.N.Y. 1997). In this case, the plaintiff operated a major and well-established conference in defendant's facilities. Defendant launched a competitive and similarly named conference simultaneously in the same building. Further, the defendant used the building's security procedures to co-register attendees for the defendant's conference, which made it easy for plaintiff's attendees to attend defendant's conference and enabled plaintiff's exhibitors to reach the same audience by paying defendant instead of plaintiff. As a result, the court cited the conferences' physical proximity and temporal adjacency (among other factors) in finding a likelihood of consumer confusion.

⁵⁸ See *McKeon Products Inc. v. Flents Products Co.*, 69 U.S.P.Q.2d 1032 (E.D. Mich. 2003) (sale of house brand earplugs adjacent to branded earplugs not an infringement); *Shell Trademark Management BV v. Canadian American Oil Co., Inc.*, 2002 WL 32104586 (N.D. Cal. May 21, 2002) (gas station could sell generic gasoline side-by-side with Shell-branded gasoline even though consumers may be pulled in by Shell brand); *Smithkline Beckman Corp. v. Pennex Products Co., Inc.*, 605 F. Supp. 746, 751-52 (E.D. Pa. 1985) (“Placing the enteric coated aspirin in close proximity to ECOTRIN® highlights the housebrand product, but that is not unfair, only competitive.”).

Cf. Kendall-Jackson Winery, Ltd. v. Superior Court ex rel E&J Gallo Winery, 76 Cal. App. 4th 970, 983 (Cal. App. Ct. 1999) (“Product adjacencies are a marketing strategy whereby a wine producer attempts to have its

retailers' ability to sell house brands that are somewhat similar to third party brands, even when the retailer clearly is capitalizing on consumer demand for the third party branded product.⁵⁹ Judges have also supported salesperson redirection of consumers asking for a particular brand,⁶⁰ store clustering⁶¹ and retailers' use of popular brands to draw consumers through a store.⁶²

Despite this, cases evaluating retailer liability for brand spillovers are relatively rare. For example, I could not find any trademark infringement lawsuits against Catalina Marketing or the retailers deploying Catalina Marketing's competitive couponing system (or, for that matter, against advertisers buying competitive coupons).⁶³ I also could not find any trademark lawsuits

brands displayed adjacent to the market leader brand in the relevant price segment....Product adjacencies are lawful and commonly used.”).

Some cases have supported this conclusion in dicta. *See* 1-800 Contacts, Inc. v. WhenU.Com, Inc., 414 F.3d 400, 411 (2005) (“it is routine for vendors to seek specific ‘product placement’ in retail stores precisely to capitalize on their competitors' name recognition. For example, a drug store typically places its own store-brand generic products next to the trademarked products they emulate in order to induce a customer who has specifically sought out the trademarked product to consider the store's less-expensive alternative”); *Merck & Co., Inc. v. Mediplan Health Consulting, Inc.*, 2006 WL 1418616, *2 (S.D.N.Y. May 24, 2006) (echoing/citing the 1-800 Contacts example); *Rescuecom Corp. v. Google Inc.*, 456 F. Supp. 2d 393, 401-02 (N.D.N.Y. 2006) (“it is routine for vendors to seek specific “product placement” in retail stores precisely to capitalize on their competitors' name recognition. For example, a drug store typically places its own store-brand generic products next to the trademarked products they emulate in order to induce a customer who has specifically sought out the trademarked product to consider the store's less-expensive alternative”).

Cf. Playboy Enters., Inc. v. Netscape Communications Corp., 354 F.3d 1020, 1035 (9th Cir. 2004) (Berzon, J., concurring) (“Similarly, suppose a customer walks into a bookstore and asks for Playboy magazine and is then directed to the adult magazine section, where he or she sees Penthouse or Hustler up front on the rack while Playboy is buried in back. One would not say that Penthouse or Hustler had violated Playboy's trademark. This conclusion holds true even if Hustler paid the store owner to put its magazines in front of Playboy's.”).

⁵⁹ *See, e.g., Conopco, Inc. v. May Department Stores*, 46 F.3d 1556, 1565 (Fed. Cir. 1994) (similar house brand does not create likelihood of confusion); *McKeon Prods., Inc. v. Flents Prods. Co.*, 69 U.S.P.Q.2d 1032 (E.D. Mich. 2002) (finding no confusion when retailers deliberately made house brands with similar trade dress to the national brands “not to confuse the customer into thinking they were buying McKeon's product, but rather to force the customer to choose between the more expensive brand name and the less expensive private label”).

⁶⁰ *See Smithkline Beckman Corp. v. Pennex Products Co., Inc.*, 605 F. Supp. 746, 752 (E.D. Pa. 1985) (“store employees who urge consumers to try or use the store brand product are certainly within their rights so long as there is no attempt to deceive the public as to the source of the goods”). *But see Coca-Cola Co. v. Overland, Inc.*, 692 F.2d 1250 (9th Cir. 1982) (restaurant's unannounced substitution of Pepsi in response to orders for “Coke” or “Coca-cola” was trademark infringement).

⁶¹ *See FragranceNet.com, Inc. v. FragranceX.com, Inc.*, 2007 WL 1821153 (E.D.N.Y. 2007) (saying, in dicta, “an individual in search of a McDonald's restaurant will often be confronted with a Burger King restaurant. As long as Burger King did not mislead the consumer under false pretenses to its location, the mere fact that it decided to place itself in close proximity to a McDonald's, in an effort to potentially draw customers in search of fast food, is not ‘passing off.’”)

⁶² *See Playboy Enters., Inc. v. Netscape Communications Corp.*, 354 F.3d 1020, 1035 (9th Cir. 2004) (Berzon, J., concurring) (“For example, consider the following scenario: I walk into Macy's and ask for the Calvin Klein section and am directed upstairs to the second floor. Once I get to the second floor, on my way to the Calvin Klein section, I notice a more prominently displayed line of Charter Club clothes, Macy's own brand, designed to appeal to the same people attracted by the style of Calvin Klein's latest line of clothes. Let's say I get diverted from my goal of reaching the Calvin Klein section, the Charter Club stuff looks good enough to me, and I purchase some Charter Club shirts instead. Has Charter Club or Macy's infringed Calvin Klein's trademark, simply by having another product more prominently displayed before one reaches the Klein line? Certainly not. [Citations omitted].”).

⁶³ In July 2007, I searched Westlaw for cases involving Catalina Marketing and looked at every case in PACER where Catalina Marketing had been sued.

over the advertising of loss leaders to create brand spillovers.⁶⁴ Even lawsuits against retailers for infringing house brands are rare.⁶⁵

II. ONLINE INTERMEDIARIES AND TRADEMARK LAW.

The last Part explained how retailers make many “editorial” decisions that generate profits from third party manufacturers’ trademarks, yet retailers generally avoid trademark liability for this behavior. This Part contrasts the legal treatment of new online intermediaries that make editorial judgments similar to those of retailers, yet the online intermediaries have received significantly more trademark scrutiny for those choices.

A. Online Intermediaries Have Usurped Retailers’ Role in the Chain.

During the 1990s, many people speculated that the Internet would lead to widespread disintermediation.⁶⁶ While much of this discussion was idealistic (perhaps naively so), the Internet has contributed to some disintermediation, such as the disintermediation of distributors and retailers as manufacturers can more easily sell directly to consumers.⁶⁷

At the same time, the Internet’s information overflow has reinforced the importance of intermediaries. To create order from chaos and control spam, the Internet needs intermediaries.⁶⁸ As a result, as much as the Internet has disintermediated the chain, the Internet has spawned a group of powerful new intermediaries who provide ordering and indexing services to help consumers manage infoglut. These new intermediaries include search engines, shopbots⁶⁹ and consumer review websites⁷⁰ (collectively, “online intermediaries”). These intermediaries play a major role in facilitating online commerce. For example, about three-quarters of all online transactions start at search engines.⁷¹

⁶⁴ Loss leaders are regulated under other doctrines, such as laws against bait-and-switch practices, predatory pricing and pricing below cost.

⁶⁵ See Jean-Noël Kapferer, *Brand Confusion: Empirical Study of a Legal Concept*, 12 PSYCH. & MARKETING 551, 553 (1995) (“Only a few companies have gone to the courts to stop [house brands]”). See also *McKeon Prods., Inc. v. Flents Prods. Co.*, 69 U.S.P.Q.2d 1032 (E.D. Mich. 2002) (manufacturer sued only the manufacturer of retailers’ house brands for infringing trade dress and not the retailers—even though the retailers had provided their trade dress to the house brand manufacturer).

⁶⁶ See Mike Hammer, *The Myth of Disintermediation*, INFO. WEEK, July 10, 2000, at 16

⁶⁷ Dell Computers is a flagship example of Internet disintermediation, where Dell sells its computers directly to consumers through its website and bypasses intermediate distributors or retailers. See John Pletz, *Dell Changed Industry with Direct Sales*, AUSTIN AMERICAN-STATESMAN, May 3, 2004. Interestingly, Dell has recently reintermediated by selling some computers through Wal-Mart. See Matt Richtel, *Coming Soon to Wal-Mart: 2 Dell PCs*, N.Y. TIMES, May 25, 2007.

⁶⁸ See Eric Goldman, *Search Engine Bias and the Demise of Search Engine Utopianism*, 8 YALE J. L. & TECH. 188 (2006).

⁶⁹ “Shopbots” are websites that aggregate retailer product/price offers and present those offers for users to compare retailers. See Maureen A. O’Rourke, *Shaping Competition on the Internet: Who Owns Product and Pricing Information?*, 53 VAND. L. REV. 1965, 1970 (1999). Shopbots are sometimes referred to as “comparison shopping engines” or “comparison engines.” Examples of shopbots include Shopping.com, Shopzilla/BizRate and MySimon.

Stereotypically, shopbots are thought to gather retailer offers from retailers automatically and without permission; in reality, because the shopbots want to be paid by the retailers for referring customers, most shopbots enter into agreements with retailers that may include the retailers regularly providing updated “feeds” of merchant offers.

⁷⁰ Prominent consumer review sites include Amazon.com (which is also an online retailer), Epinions.com (which is part of Shopping.com/eBay and also acts as a shopbot) and Yelp.

⁷¹ Melanie Mitchell, *Handling Search Marketing in Large Organizations*, Search Engine Watch, May 8, 2007, <http://searchenginewatch.com/showPage.html?page=3625800>. This rate appears to be increasing. In 2002, about

As a result, just as retailers interpose themselves between manufacturers and consumers, online intermediaries now effectively interpose themselves between consumers and retailers. As a result, retailers now depend heavily on online intermediaries for access to online customers.⁷² In effect, by obtaining frontline control over shoppers, online intermediaries have partially usurped the retailers' role in the distribution chain.

But online intermediaries are not merely battling retailers for position in the distribution chain. Instead, online intermediaries are now performing many functions traditionally performed by retailers,⁷³ making the substitutability of online intermediaries and retailers even more pronounced.

For example, consider how much Google looks like a retailer described in Part I *supra*. After a consumer submits a keyword search, Google presents the consumer with advertisements that are “merchandised” based on the consumer's past search interactions with Google,⁷⁴ the consumer's location⁷⁵ and Google's own assessments of relevancy.⁷⁶ Consumers can then navigate through the search results and ads to do comparison shopping.⁷⁷ Google even helps the consumer purchase the item from a third party retailer by accepting and processing the consumer's payment through its “Checkout” service.⁷⁸ When consumers follow this process completely, Google has, in practice, displaced the retailer. True, the retailer may get the ultimate sale, but Google has controlled all of the meaningful facets of the consumer experience—just like a retailer would control the experience offline. Ultimately, if Google can consistently provide an integrated user experience, Google can completely displace the relationships between consumers and retailers.

Google is hardly alone as an online intermediary displacing retailers. eBay and Amazon have become a major marketplace by providing many of the services of traditional retailers, even if its third party merchants consummate the final sale. Shopbots also may offer their own “shopping cart” technology allowing a consumer to consummate transactions with third party retailers through the shopbot's system.⁷⁹ Thus, the trend appears to be that online intermediaries

half of e-commerce sessions began at search engines. See Paul J. Bruemmer, *Drive Holiday Sales With Search Engine Marketing*, Pandia, Oct. 19, 2002, <http://www.pandia.com/sw-2002/36-holiday.html>.

⁷² See JOHN BATTELLE, *THE SEARCH* (2005) (discussing the challenges experienced by Neil Moncrief, operator of 2bigfeet.com, after being kicked out of Google right before the holiday shopping season); Michael Totty & Mylene Mangalindan, *Web Sites Try Everything To Climb Google Rankings*, WALL ST. J., Feb. 26, 2003 (discussing how a retailer's sales dropped 80% after having its ranking reduced in Google).

⁷³ See Kevin Lee, *Paying for Shelf Space in the Search Supermarket*, ClickZ News, Sept. 1, 2006, <http://www.clickz.com/showPage.html?page=3623308> (analogizing search engine keyword ads to manufacturers paying slotting fees).

⁷⁴ See Zachary Rodgers, *Google Targets Search Ads on Prior Queries, à la Behavioral*, ClickZ News, July 31, 2007, <http://clickz.com/showPage.html?page=3626593>.

⁷⁵ See Google.com, *Regional and Local Targeting: Sharpen Your Advertising Focus*, <https://adwords.google.com/select/targeting.html>.

⁷⁶ See Google.com, *How are Ads Ranked?*, <http://adwords.google.com/support/bin/answer.py?answer=6111&topic=115> (discussing Google's “Quality Score for Ad Rank”).

⁷⁷ See Gord Hotchkiss, *Tales of Pogo Sticks, Bouncy SERPs and Sticky Pages*, Search Engine Guide, Sept. 11, 2006, http://www.searchengineguide.com/hotchkiss/2006/0911_gh1.html (about 1 in 2 searches involve pogo-sticking where the searcher checks out an individual search result and returns back to the search results list).

⁷⁸ Google.com, Google Checkout, <https://checkout.google.com>.

⁷⁹ Posting of Scot Wingo to Comparison Shopping Engine Strategies Blog, *A Look at Shopping.com's New Checkout System*, Nov. 7, 2006, http://www.csestrategies.com/cse/2006/11/a_look_at_shopp.html.

will capitalize on their relationship with consumers to provide the services traditionally associated with retailers.

B. Online Intermediaries Face Trademark Liability Where Retailers Don't.

The previous subpart portrayed online intermediaries as the new equivalent of retailers in the distribution chain. Given their highly similar functions, it would make sense that trademark law would treat online intermediaries similarly to retailers for engaging in profit-maximizing capitalization of brand spillovers—that is, as it does with retailers, trademark law would largely ignore the behavior of online intermediaries.

Yet, their trademark liability appears to differ. Online intermediaries (especially search engines) have been sued repeatedly under trademark law for profiting from brand spillovers⁸⁰—especially for selling a third party's trademark as a keyword to trigger competitive advertising (“keyword triggering”). The final legal resolution remains uncertain; as of July 1, 2007, no United States court has issued a final adverse trademark judgment against online intermediaries.⁸¹ However, courts have fractured on the appropriate legal resolution of these cases, and numerous courts have rendered adverse judgments that raise serious legal doubts about the legal state of keyword triggering specifically or brand spillover activity online generally.⁸² Indeed, to minimize their liability, many online intermediaries have “trademark policies” that give trademark owners an extra-judicial recourse to stop certain types of brand spillovers.⁸³

Despite the trademark owner-favorable jurisprudence and the voluntary takedown option offered by online intermediaries, two state legislatures (Alaska and Utah) have intervened legislatively by banning online intermediaries for engaging in keyword triggering in certain contexts.⁸⁴ For now, based on current developments in the courts and the legislatures, the trend appears to be towards imposing significant trademark liability on online intermediaries for their brand spillovers activities.

III. OPTIMIZING TRADEMARK LAW FOR INTERMEDIARIES.

⁸⁰ For an aggregation of the cases that have reached some resolution, see Eric Goldman, Keyword Law, <http://www.ericgoldman.org/Speeches/smukeywordlaw.pdf>.

⁸¹ See Eric Goldman, Keyword Law, <http://www.ericgoldman.org/Speeches/smukeywordlaw.pdf>. The only possible exception to this is *Washingtonpost v. Gator*, 2002 WL 31356645 (E.D. Va. 2002), where the court issued a preliminary injunction against an adware vendor engaged in keyword triggering, but the order itself provided no explanation, and the court never reached the question of a final injunction.

In contrast, internationally, numerous courts have ruled against online intermediaries in keyword triggering trademark lawsuits. See Google Form 10-K for the Fiscal Year Ended Dec. 31, 2006, at 23; *Google's Ad Words Under Attack - Overview Over the Pending Lawsuits*, Links & Law, <http://www.linksandlaw.com/adwords-pendinglawsuits.htm>.

⁸² To be clear, other courts have completely absolved online intermediaries from trademark liability for their brand spillovers activities. See Eric Goldman, Keyword Law, <http://www.ericgoldman.org/Speeches/smukeywordlaw.pdf>

⁸³ See, e.g., Google.com, AdWords Trademark Complaint Procedures, http://www.google.com/tm_complaint_adwords.html; Google.com, AdSense for Domains Trademark Complaint Procedure, http://www.google.com/tm_complaint_afd.html; Microsoft, adCenter Trademark Policy, http://advertising.microsoft.com/Home/Article.aspx?pageid=708&Adv_Articleid=3216; Yahoo, Raising Trademark Concerns about Sponsored Search™ Listings, <http://searchmarketing.yahoo.com/legal/trademarks.php>.

⁸⁴ Utah actually banned keyword triggering twice. Utah Spyware Control Act (2004; amended 2005) (focusing only on adware); Utah Trademark Protection Act (2007). Alaska banned keyword triggering via adware in 2005. Alaska SB 140 (2005).

As Part II explains, there appears to be a split between the trademark law treatment of retailers and online retailers. This Part tries to rationalize this dichotomy.

A. Why Are Online/Offline Intermediaries Be Treated Differently?

If retailers and online intermediaries perform similar functions, then we might expect their legal treatment to be roughly equivalent as well. However, perhaps there is some good reason to distinguish between retailers as intermediaries and online intermediaries. This subpart explores some possible explanations for the dichotomous legal treatment:

Hypothesis #1: Spillovers in Every Direction

While retailers may take advantage of spillovers, from a manufacturer's perspective, it is not always clear which direction the spillovers flow. For example, Coca-Cola might feel disadvantaged when retailers regularly advertise its brand as a loss leader to stimulate sales of third party products. At the same time, Coca-Cola may get positive spillovers from retailers' other merchandising decisions. For example, a retailer may promote liquor concoctions (such as "Rum and Coke") that have the effect of increasing profits for both the retailer and Coca-Cola. As a result, any manufacturer may not know if retailer merchandising of its brand is, on balance, *net* positive or negative for it. If so, manufacturers may tolerate retailer-created spillovers because they think they get the benefit of the spillovers or because they cannot determine the effect.

However, even if spillovers indeterminately flow in every direction in the retail context, this hypothesis does not explain the retailer/online intermediary dichotomy. Spillovers flow in every direction online as well. For example, numerous plaintiffs who have sued over keyword triggering have bought competitive keyword-triggered ads themselves⁸⁵—effectively, taking advantage of the same spillover activities that they are trying to stop.

Alternatively, trademark owners may be trying to improve their overall spillover profile by reducing negative spillover activities while retaining positive ones. But manufacturers would have the same incentives to exercise these types of partial vetoes in the offline retail context as well, but they do not. Therefore, this hypothesis does not provide a satisfactory explanation for the retailer/online intermediary dichotomy.

Hypothesis #2: No Actual Spillovers

Another possibility is that spillovers do not actually exist in the retail context because manufacturers and retailers set prices to properly internalize any spillovers. So, if a manufacturer believes retailers are profiting from brand spillovers attributable to the manufacturer, the manufacturer increases the retailer's price to reflect this benefit.

Some evidence supports this hypothesis. Retailers generally earn lower margins on items with strong consumer brands⁸⁶ because consumers may not patronize a retailer that does not

⁸⁵ See, e.g., *1-800 Contacts v. WhenU*, 414 F.3d 400 (2d Cir. 2005) (1-800 Contacts had purchased keyword ads from adware vendors); *Buying for the Home v. Humble Abode*, 459 F. Supp. 2d 310 (D. N.J. 2006) (both plaintiff and defendant had bought each other's trademarks as keywords); *Google Inc. v. American Blind & Wallpaper Factory, Inc.*, 2007 WL 1848665 (N.D. Cal. 2007) (American Blinds purchased competitors' keywords). Indeed, when Utah passed the Utah Trademark Protection Act to outlaw keyword triggering, leading the charge against the law were two Utah trademark owners (1-800 Contacts and Overstock.com) who were repeat litigants over keyword triggering—but also big buyers of their competitors' trademarks. See Linda Fantin, *Lawmakers Could Rethink Online Registry*, SALT LAKE TRIB., Apr. 26, 2007.

⁸⁶ See Michael P. Lynch, *Why Economists Are Wrong to Neglect Retailing and How Steiner's Theory Provides an Explanation of Important Regularities*, 49 ANTITRUST BULL. 911 (2004).

carry their preferred brand.⁸⁷ This suggests that retailers may pay a comparative premium for these items that internalizes any spillover benefits that these items generate. Further, manufacturers may simultaneously sell products both their prominently branded product *and* provide the retailer's house brand⁸⁸ effectively in competition with each other, ensuring that the manufacturer gets the sale either way.

This hypothesis also might explain the retailer/online intermediary dichotomy. Manufacturers and retailers generally are in contractual privity (directly or indirectly), while manufacturers may lack any privity with online intermediaries. Privity provides manufacturers with an extra-judicial mechanism to pass spillovers through to online intermediaries.

However, the differences in privity may not fully explain the dichotomy. First, a typical chain of distribution interposes one or more distributors between manufacturers and retailers, so manufacturers do not have direct privity with retailers.⁸⁹ Second, manufacturers cannot completely control their distribution channels, so retailers may be able to purchase manufacturers' items from unexpected sources where the pricing may not contemplate the retailers' spillover activities. Finally, retailers use very disparate merchandising practices, so manufacturers may not be able to assess a retailer's possible merchandising practices to internalize the spillovers into the pricing.

*Hypothesis #3: Manufacturers Are Reluctant to Sue Retailers*⁹⁰

Another possibility is that manufacturers are reluctant to sue retailers,⁹¹ perhaps because retailers are the power players in the distribution chain⁹² and can cut off manufacturers' access to consumers.⁹³ However, this hypothesis is not very robust. While retailers as a class are powerful, manufacturers could still safely pursue individual retailers who are relatively weak, such as retailers who have a small percentage of the manufacturer's market share. Further, manufacturers will sue retailers in the right circumstances, such as when retailers' house brands are too close to manufacturers' brands.

⁸⁷ See Jerre B. Swann et al, *Trademarks and Marketing*, 91 TRADEMARK REP. 787, 810 (2001) ("Strong brands...can provide manufacturers with a bargaining chip in the 'channel' game. Loyal customers generate 'pull' for the brand: if a retailer does not stock what they are looking for, consumers will be unhappy."); Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J. L. & ECON. ____ (2007).

⁸⁸ See Ellen Byron, *101 Brand Names, 1 Manufacturer*, WALL ST. J., May 9, 2007, at B1 ("In many cases, the maker of a brand-name product will also produce private-label versions.").

⁸⁹ That is, the distributor may set the price to the retailer. Of course, a manufacturer could vary its distributor price to indirectly influence the price charged to retailers.

⁹⁰ This could be characterized as a subset of the broader risks associated with suing customers. See, e.g., G. Richard Shell, *Suing Your Customers: A Winning Business Strategy?*, Knowledge@Wharton, Oct. 22, 2003, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=863>.

⁹¹ See Colleen Collins-Dodd & Judith L. Zaichkowsky, *National Brand Responses to Brand Imitation: Retailers Versus Other Manufacturers*, 8 J. PRODUCT & BRAND MGMT 96 (1999). See also *McKeon Prods., Inc. v. Flents Prods. Co.*, 69 U.S.P.Q.2d 1032 (E.D. Mich. 2002) ("it is packaging selected by the retailers Walgreens and Albertson's which is the subject of this case. While the Court is not basing its decision solely on this point, the Court is troubled that Walgreens and Albertson's--the entities that purportedly selected the trade dress at issue--are not Defendants in this litigation. While the Court understands the reasons for McKeon's desire not to sue its own customers, the Court is nonetheless bothered by their absence from this litigation.").

⁹² See Jack Hitt, *The Theory of Supermarkets*, N.Y. TIMES, March 10, 1996 at 56 (UPCs and scanners have shifted power from manufacturers to retailers by increasing retailer knowledge about sales activity).

⁹³ See Ellen Byron, *101 Brand Names, 1 Manufacturer*, WALL ST. J., May 9, 2007, at B1 ("Some consumer-product companies have been forced to make both generic and branded products to please retailers. 'If a major manufacturer is unwilling to produce private-label products, there's a possibility the retailer won't sell their branded products.'").

Further, this hypothesis does not explain the retailer/online intermediary dichotomy. As explained earlier, online intermediaries are the new power brokers in the distribution chain, and manufacturers do not want to risk retaliation that cuts off consumer access.⁹⁴ Perhaps manufacturers may feel that online intermediaries have more “editorial integrity” than retailers and thus would be less likely to engage in manufacturer-specific retribution. Nevertheless, online intermediaries can and do make subjective judgments about their content,⁹⁵ so suing them necessarily entails some risk. As a result, due to their important gatekeeping functions, manufacturers should be reluctant to sue either retailers or online intermediaries.

Hypothesis #4: Retailers and Online Intermediaries Have Legally Significant Differences

Existing trademark law may be more favorable to retailers than online intermediaries. (Part III(B) will advocate for harmonized legal treatment).

First, retailers benefit from the “first sale”/“trademark exhaustion” doctrine for their merchandising practices, but online intermediaries cannot. The “first sale” doctrine (also called “trademark exhaustion”) limits a trademark owner’s ability to restrict the resale and promotion of legitimately acquired goods.⁹⁶ As a result, a retailer is entitled to promote the availability of the goods it sells. In contrast, online intermediaries usually cannot claim the first sale doctrine because they do not sell goods directly. Thus, the first sale doctrine might explain the retailer/online intermediary dichotomy.

However, online intermediaries do benefit from a partially analogous doctrine—the printer/publisher limit on remedies.⁹⁷ However, the printer/publisher doctrine is largely untested in the online context,⁹⁸ and it only restricts damages, not injunctions.⁹⁹ Further, it expressly applies only to “innocent” infringers—which may or may not apply to brand spillovers, where a judge might view such spillovers as misappropriative or unfair. Therefore, it remains to be seen if the printer/publisher doctrine helps online intermediaries as much as the first sale doctrine helps retailers with brand spillovers.

Second, retailers may not satisfy the requisite “use in commerce” of manufacturer trademarks when merchandising, while online intermediaries might. The federal Lanham Act regulates a defendant’s “use in commerce” of a third party trademark “in connection with goods or services.”¹⁰⁰ This “use in commerce” has led to frustratingly confused jurisprudence for online intermediaries,¹⁰¹ for good reason. The federal Lanham Act has two independent definitions:

⁹⁴ See Oren Bracha & Frank Pasquale, *Federal Search Commission? Access, Fairness and Accountability in the Law of Search*.

⁹⁵ See Eric Goldman, *Search Engine Bias and the Demise of Search Engine Utopianism*, 8 YALE J. L. & TECH. 188 (Spring 2006); Posting of Matt Cutts to Gadgets, Google, and SEO, *The Role of Humans in Google Search*, June 23, 2007, <http://www.mattcutts.com/blog/the-role-of-humans-in-google-search/>; Randall Stross, *The Human Touch That May Loosen Google's Grip*, N.Y. TIMES, June 24, 2007.

⁹⁶ See *Prestonettes, Inc. v. Coty*, 264 U.S. 359 (1924); *Sebastian Int'l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073 (9th Cir. 1995).

⁹⁷ 15 U.S.C. §1114(2).

⁹⁸ On August 23, 2007, I conducted a search in Westlaw [1114(2) /p trademark /s (printer publisher)] and got less than ten different cases.

⁹⁹ 15 U.S.C. §1114(2).

¹⁰⁰ 15 U.S.C. §1114(a) (registered marks); 15 U.S.C. §1125(a) (unregistered marks); *1-800 Contacts, Inc. v. WhenU.Com, Inc.*, 414 F.3d 400, 411 (2005).

¹⁰¹ See Eric Goldman, *Online Word of Mouth and Its Implications for Trademark Law*, in TRADEMARK LAW AND THEORY: A HANDBOOK OF CONTEMPORARY RESEARCH (Graeme B. Dinwoodie and Mark D. Janis eds.) (Edward Elgar Press, 2007); Graeme Dinwoodie & Mark Janis, *Confusion Over Use: Contextualism in Trademark Law*, 92

first, a definition of “commerce” that de facto eliminates the factor in the plaintiff’s prima facie case,¹⁰² meaning that online intermediaries may make a use in commerce even though their trademark references are invisible to consumers; and second, a definition of “use in commerce” that focuses on the defendant’s placement of the trademark on external packaging or in product advertising.¹⁰³ Because these definitions are facially inconsistent but the statute does not provide adequate guidance to select between the two, judges have effectively split in their statutory interpretations.¹⁰⁴

But neither interpretation adequately explains the dichotomy. Assuming the more expansive theory (trademark use in commerce occurs without any visible trademark display), both retailers and online intermediaries use manufacturer trademarks “invisibly”: in retailers’ case, such usage occurs in shelf adjacency where the manufacturer’s trademark implicitly draws customers to third party goods, and in online intermediaries’ case, when engaged in keyword triggering. In both cases, the manufacturer trademark acts as a common referent for third party products that can generate additional profits for the intermediary. Thus, from a statutory standpoint, these activities are indistinguishable as uses in commerce. Yet, numerous courts have held that keyword triggering is a trademark use in commerce.¹⁰⁵

These analyses are highly fact-specific. For example, in some cases the online intermediary does display the trademark when keyword triggering, increasing the odds that a court will deem this a use in commerce;¹⁰⁶ similarly, when retailers advertise a prominent brand as a loss leader, they are making a use in commerce in the ad copy, though it may be protected by the first sale doctrine. However, in the “pure” cases, where both retailers and online intermediaries do not reference a third party trademark in a manner visible to consumers, the legal treatment seemingly should be the same. Therefore, even though there may be differences in the current legal doctrines, these differences do not appear to explain the entire dichotomy.

Hypothesis #5: Cyberspace Exceptionalism

A final hypothesis is that the dichotomy reflects cyberspace exceptionalism. Cyberspace exceptionalism refers to the development of Internet-specific laws that treat the Internet as unique/special/different.¹⁰⁷ In some cases, the Internet actually does create new issues that warrant custom-tailored legal solutions; more frequently, cyberspace exceptionalism reflects an exaggeration of the Internet’s purported differences as part of a policy overreaction.

As a technology, keyword triggering seems especially susceptible to cyberspace exceptionalism. After all, the triggering process is unfamiliar and vaguely mysterious to

IOWA L. REV. __ (2007); Mark Lemley & Stacey Dogan, *Grounding Trademark Law Through Trademark Use*, 92 IOWA L. REV. __ (2007).

¹⁰² 15 U.S.C. §1127 (defining “commerce” as “all commerce which may lawfully be regulated by Congress”—effectively equivalent to Congress’ Commerce Clause powers, which have very few limits).

¹⁰³ 15 U.S.C. §1127.

¹⁰⁴ Eric Goldman, Keyword Law, <http://www.ericgoldman.org/Speeches/smukeywordlaw.pdf>.

¹⁰⁵ See, e.g., *Edina Realty v. TheMLSonline.com*, 2006 WL 737064 (D. Minn. 2006); *Buying for the Home v. Humble Abode*, 459 F. Supp. 2d 310 (D. N.J. 2006); *J.G. Wentworth v. Settlement Funding*, 2007 WL 30115 (E.D. Pa. 2007); *GEICO v. Google*, 330 F. Supp. 2d 700 (E.D. Va. 2004); *Google v. American Blinds*, 2005 WL 832398 (N.D. Cal. 2005); motion reconsidered 2007 WL 1159950 (N.D. Cal. 2007); *800-JR Cigar v. GoTo.com*, 437 F. Supp. 2d 273 (D. N.J. 2006).

¹⁰⁶ See *Hamzik v. Zale Corp./Delaware*, 2007 WL 1174863 (N.D.N.Y. 2007) (reference to third party trademark in ad copy is a trademark use in commerce; but using the trademark as a keyword trigger, without more, is not).

¹⁰⁷ See Julie E. Cohen, *Cyberspace as/and Space*, 107 COLUM. L. REV. 210 (2007).

consumers (and judges),¹⁰⁸ and this gives courts a reason to treat it suspiciously. Over time, consumers will better understand keyword triggering technologies and other online intermediary practices.

In contrast, retailers have been using brand spillover merchandising practices for (in some cases) decades, so superficially they may seem more intuitive to consumers and judges. Yet, retailers engage in many merchandising practices that consumers do not understand any better than they understand keyword triggering,¹⁰⁹ either because they are relatively recent/unknown (such as slotting fees and category management) or because consumers simply do not think about them. As with keyword triggering, some of these newer merchandising practices have generated some policy angst,¹¹⁰ but there has not been any concerted regulatory response to retailers' brand spillovers.

Keyword triggering also may appear to be unfair to the trademark owner, especially if one assumes that a searcher entering a trademark into a search term is looking for the trademark owner. Based on this assumption, a competitor interposing themselves between the searcher and the trademark owner (and an online intermediary facilitating that interposition) is "stealing" the customer.¹¹¹ However, many consumers entering a trademarked search term are not looking for the trademark owner,¹¹² undercutting this assumption and the associated hyperbolic rhetoric.

Further, consumer redirection to different manufacturers is hardly new or unique to cyberspace. As discussed in Part I(A), for decades retailers have surreptitiously "used" third party trademarks to facilitate their profits and the profits of unrelated manufacturers. Perhaps the most conspicuous analogous behavior is grocers' in-store delivery of purchase-based coupons for third party manufacturers. Like keyword triggering, these couponing services "use" trademarks surreptitiously to cause the display of competitive advertising to consumers; and if they work as planned, the coupons cause consumers to "divert" from their loyal brand to the competitive brand for future purchases. Yet, apparently no plaintiffs, courts or legislatures thought retailers or the purchasing advertisers were liable for trademark infringement because of the coupon delivery. Why not? Based on this subpart's consideration of hypotheses, cyberspace exceptionalism is a leading candidate.

¹⁰⁸ At two of the leading keyword triggering cases, plaintiffs introduced evidence that consumers did not understand the keyword triggering process. In the 2003 *1-800 Contacts v. WhenU* case, the plaintiff introduced survey evidence that a majority of surveyed consumers mistakenly thought adware-delivered pop-ups were (1) delivered by the underlying websites, and (2) those websites had prescreened and approved the ads. See *1-800 Contacts, Inc. v. WhenU.com*, 309 F. Supp. 467, 500 (S.D.N.Y. 2003), *rev'd* 414 F.3d 400 (2d Cir. 2005). In the 2004 *Playboy v. Netscape* case, the plaintiff introduced survey evidence that a majority of searchers for the term "playboy" thought Playboy Enterprises sponsored or was affiliated with the keyword-triggered third party ads. See *Playboy Enters. Inc. v. Netscape Communications Corp.*, 354 F.3d 1020 (9th Cir. 2004). Both surveys were ultimately subject to significant criticism by the courts and given less weight accordingly, but directionally they might provide some evidence that consumers did not understand why they were seeing the material presented to them.

¹⁰⁹ See Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1447 (1999).

¹¹⁰ For example, the emergence of slotting allowances led to several Congressional hearings and Federal Trade Commission workshops. See Federal Trade Commission, *Report on the Federal Trade Commission Workshop on Slotting Allowances and Other Marketing Practices in the Grocery Industry* 1-2 (Feb. 2001).

¹¹¹ For example, Sen. Dan Eastman, sponsor of Utah's anti-keyword triggering law, describes keyword triggering as a type of "corporate identity theft" and says that keyword triggering leads to consumers being "shanghaied" and "carjacked." Posting of Dan Eastman to The Senate Site, *Identity Theft: The Next Generation*, Apr. 5, 2007, <http://senatesite.com/blog/2007/04/identity-theft-next-generation.html>.

¹¹² See Eric Goldman, *Deregulating Relevancy in Internet Trademark Law*, 54 EMORY L.J. 507 (2005).

B. A Harmonized Trademark Law for Intermediaries.

Even if trademark liability for keyword triggering is a product of unwarranted cyberspace exceptionalism, this still leaves open the question of the right trademark policy for merchandising by intermediaries. Should the policy be more like the offline retailer standard, where taking advantage of brand spillovers does not create liability, or should it look more like the online standard, which is veering towards imposing liability?

To evaluate this decision, it is helpful to isolate how retailers add value in the distribution chain. If there were no transaction costs, intermediaries would be unnecessary; manufacturers and consumers would deal directly with each other. However, in a world with transaction costs, intermediaries offer valuable services to both manufacturers and consumers. For example, retailers purchase from manufacturers in bulk, which can reduce the costs of packaging and shipping from manufacturers to consumers; instead of manufacturers redundantly shipping individually packaged items to geographically proximate consumers, manufacturers can more efficiently package and ship in bulk to a single retailer who serves those consumers.

Retailers as Search Cost Managers

Retailers also add value in the distribution chain by gathering information about consumer segments more cheaply than manufacturers. Learning consumer preferences and recording and understanding consumer behavior is a costly endeavor, and for manufacturers, the cost-benefit of learning about consumer segments becomes disadvantageous as the segments become smaller. In contrast, retailers often focus on specific consumer segments (based on some common consumer attribute like geography or industry), and retailers often can spread their research costs across multiple manufacturers. This enables retailers to understand the needs of their specific consumer base more cost-effectively than manufacturers. This makes retailers the comparative “experts” in the distribution chain about the retailers’ particular consumers’ needs.

Based on this information, retailers can add value to consumers as well. Consumers are hindered by a number of different types of marketplace confusion,¹¹³ including having too much and too little information.¹¹⁴ Retailers can use their specialized knowledge about their consumers’ needs to make the types of “editorial” choices that enhance consumer understanding and decision-making.¹¹⁵ When a retailer makes wise editorial choices, the retailer helps its consumers sort through their confusion to find what they are looking for and, not coincidentally, increases the retailer’s revenue and profit. Viewed this way, retailers are in the business of helping reduce consumer search costs.¹¹⁶

¹¹³ See Vincent-Wayne Mitchell et al., *Towards a Conceptual Model of Consumer Confusion*, 32 *ADVANCES IN CONSUMER RESEARCH* 143 (2005) (proposing a typology of consumer confusion that includes “brand similarity confusion,” “overload confusion,” and “ambiguity confusion”).

¹¹⁴ For a discussion about consumers’ problems with information overload in retail environments, see BARRY SCHWARTZ, *THE PARADOX OF CHOICE* (2004). Schwartz’s book downplays the role of retailers in managing consumer information overload, although some of his examples—such as the retailer who sold more jam by offering 6 varieties instead of 24—confirms that retailers have profit motivations to more effectively manage consumer search costs.

¹¹⁵ See PACO UNDERHILL, *WHY WE BUY* 203 (1999) (product adjacencies are “about order—coming up with a sensible, logical sequence of products”).

¹¹⁶ See Mitra B. Sarkar et al., *Intermediaries and Cybermediaries: A Continuing Role for Mediating Players in the Electronic Marketplace*, *J. COMPUTER MEDIATED COMMUNICATIONS*, 1995, <http://jcmc.indiana.edu/vol1/issue3/sarkar.html>. This may be one of the main reasons why consumers hate wait times at retailers. See PACO UNDERHILL, *WHY WE BUY* 189-94 (1999).

To see just how important it is for retailers to reduce consumer search costs, consider how the consumer shopping experience would degrade if retailers use a suboptimal taxonomy. We generally assume that retailers will taxonomize their goods by function or type and that this organizational scheme is the most sensible, but retailers could—and occasionally do—use alternative organizational schemes:¹¹⁷

By brand. Retailers can organize their products by brand.¹¹⁸ For example, music stores and bookstores typically organize their offerings alphabetically by artist/author name (at least, within broad topical categories), some clothing retailers establish dedicated areas for clothes from a particular clothing manufacturer, and art galleries may organize their wares by artist. In theory, all retailers could adopt a brand-based organizational scheme. For example, a grocery store could put all of the Del Monte-branded products next to each other, followed by the group of Dole-branded products. With such an organization, consumers with established brand loyalties would probably experience reduced consumer search costs when they went an unfamiliar grocery store (i.e., in such a store, a consumer who wanted Sprite Cola could simply go to the S section rather than searching for the soda aisle).

By price. Retailers can organize their products by price, such as from low price to high price. While some retailers charge a flat price for all items in the store (such as the dollar stores) and others may arrange products by price within specific product categories,¹¹⁹ but I have not been able to identify retailers who organize all of their products by price across-the-board—such as a grocery store that organizes its groceries from \$0.01 on up.¹²⁰ This type of pricing system would have the advantage (to the retailer) of encouraging a consumer to disclose his/her reservation price; for example, a consumer willing to pay up to \$0.89 for a 15 ounce can of garbanzo beans could go to the “\$0.89 section” and see if any cans are offered at that price; if none are, the consumer could walk down the aisle in price until the consumer found such a can (if any).

From a trademark law standpoint, a brand- or price-based organizational scheme would likely substantially reduce shelf adjacency-based brand spillovers. A brand-based taxonomy would ensure that competitive brands are segregated, reducing the risk of diversion between competitive brands.¹²¹ A price-based taxonomy would eliminate retailers’ ability to benefit from

¹¹⁷ See generally Greg Lastowka, *Search Engines, HTML, and Trademarks: What's the Meta For?*, 86 VA. L. REV. 835 (2000) (discussing how a store could organize its goods just by throwing random goods into a bin and requiring consumers to sort through the bins).

¹¹⁸ Cf. *Gray v. Meijer, Inc.*, 295 F.3d 641 (6th Cir. 2002) (grocer organized products by source so that house brands were segregated from third party branded products). I am not addressing retailers who carry the product line of a single manufacturer or a limited handful of manufacturers.

¹¹⁹ This may be an example of the framing effect. A higher-priced product may make the cheaper product look like a comparative bargain. Psychologist Barry Schwartz gives a good example of this. A catalog offering a \$279 bread maker later added a new \$429 bread maker. The catalog sold relatively few \$429 bread makers, but sales for the \$279 bread maker doubled. See BARRY SCHWARTZ, *THE PARADOX OF CHOICE* (2004).

¹²⁰ Clearly, a truly comprehensive price-based organizational scheme would have some inefficiencies in the grocery context. For example, putting all of the refrigerated/frozen goods together limits the number of refrigeration units required, and a change in a product’s price would require the product to be restocked at the new price.

¹²¹ See *Gray v. Meijer, Inc.*, 295 F.3d 641 (6th Cir. 2002):

As Gray contends, Meijer [the retailer] controlled the placement of the products, and it chose to put Gray's product with other independent brands and its own product with other Meijer products. Though popcorn was in the same basic area, we agree with the district court in the importance of the placement of the products, as it can naturally be inferred that if Meijer had sought to confuse and trade-off Gray's popcorn brand, then it would have placed them side-by-side rather than surround its popcorn with other Meijer products, which clearly indicates that all products in that section are Meijer products. As the district court concluded, “[a] purchaser with even a minimal

price differentials to divert consumers from heavily branded products to cheaper house brands.¹²² In both cases, there may be limited brand spillovers at a category's physical borders or as a consumer walks down the aisle, but such spillovers would be largely serendipitous.

Nevertheless, focusing just on the grocery store context for a moment, organizing products by brand or by price would strike most consumers as silly and frustrating.¹²³ A brand-based organization would frustrate consumers seeking to compare brands; they would have to traipse through the store to find comparable items (assuming the consumer knew the relevant brands), and side-by-side comparison would be difficult. When consumers want to buy multiple goods in the same trip, this exercise would quickly prove exasperating.

Price-based organization for groceries would not be any more pleasant. Consumers without well-established reservation prices for goods will not be able to navigate by price, and most consumers would prefer to avoid paying their maximum reservation price for every item. Consumers who have strong brand preferences will also incur extra search costs trying to map their desired brands to the store's price. Meanwhile, consumers also would struggle to comparison shop because of the difficulty finding comparable items.

The idea of brand-based and price-based organization is admittedly somewhat fanciful, but it reminds us that consumers depend heavily on retailers to develop logical and efficient organizational systems. While not every retailer decision speeds up consumer shopping, retailers compete in part on the efficiency of their organization,¹²⁴ and they can suffer marketplace consequences when they degrade consumer efficiency.¹²⁵ Therefore, retailers act as “search cost managers” for consumers—it is one of their key ways of adding value in the chain, and they can provide significant value to society doing this job well.¹²⁶

Online Intermediaries as Search Cost Managers

Retailers are not the only search cost managers in the economy. Instead, every intermediary interacting with consumers will provide search cost management as a way of adding value to consumers. It is endemic in the nature of intermediation.

As a result, like retailers, online intermediaries also act as search cost managers for consumers.¹²⁷ For example, search engines compete with each other to deliver search results

degree of care and sophistication would not reasonably believe that the Grays' popcorn product was placed alone amidst a sea of Meijer's private label products. The placement of the products minimizes the likelihood of confusion between the products. This factor favors Meijer.”

¹²² The retailer could still put house brands next to the branded products, but if there is no differential in price, the likelihood of diversion should drop substantially.

¹²³ See Jack Hitt, *The Theory of Supermarkets*, N.Y. TIMES, March 10, 1996 at 56 (arranging cereal by type (i.e., bran or flakes) reduces sales by 5%).

¹²⁴ See PACO UNDERHILL, WHY WE BUY 203 (1999) (discussing an innovative Italian grocer who organized its products by meal, i.e., all dinner items grouped together).

¹²⁵ For example, when grocers put staples like milk and eggs at the back of the store, convenience stores could position those products more conveniently and capture market share. See PACO UNDERHILL, WHY WE BUY 82 (1999). In response, some grocers created a “shallow loop” where the staples are positioned upfront to compete more effectively with the convenience stores. See *id.*

¹²⁶ Cf. *Gallo Motor Center Corp. v. Mazda Motor of Am.*, 204 F. Supp. 2d 144, 154 (D. Mass. 2002) (auto dealer clustering “promotes interbrand and intrabrand competition which ultimately reduces prices while expanding sales and service options”).

¹²⁷ See, e.g., Yannis Bakos, *The Emerging Landscape for Retail E-Commerce*, 15 J. ECON. PERSPECTIVES 69 (2001); Mitra B. Sarkar et al., *Intermediaries and Cybermediaries: A Continuing Role for Mediating Players in the Electronic Marketplace*, J. COMPUTER MEDIATED COMMUNICATIONS, 1995, <http://jcmc.indiana.edu/vol1/issue3/sarkar.html>.

that resolve consumers' needs more efficiently¹²⁸—a competition that has the socially beneficial effect of lowering consumer search costs.¹²⁹ Just as retailers use brand spillovers as part of their intermediation, online intermediaries may use brand spillovers such as keyword triggering to reduce consumer search costs.¹³⁰

Brand Spillovers and Trademark Policy

By definition, brand spillovers are a positive externality as trademark owners create economic benefit for intermediaries and third party manufacturers. Accordingly, brand spillovers look like a marketplace deficiency that requires regulatory correction. Otherwise, according to neo-classical economics, trademark owners will underinvest in their trademarks because they are not receiving the full economic benefit from their investments. This logic suggests that keyword triggering should be trademark infringement; but the logic would also dictate that other brand spillover activities, such as the retailer activities described in Part I(B), should be trademark infringement as well.

On the other hand, the mere existence of spillovers does not dictate that regulatory intervention is required. As Frischmann and Lemley recently explained, not every spillover needs internalization, and it may be socially inefficient to attempt to correct all spillovers.¹³¹

In this situation, there are good reasons to be suspicious of regulation of brand spillovers. First, brand spillovers have been a successful and essential part of our retailing economy for decades. Our marketplace appears to be functioning well, and trademark owners have not experienced any obvious disincentive to invest in their brands.

Second, to the extent that intermediaries are competing with each other to lower consumer search costs, regulatory intervention to restrict brand spillovers has the risk of taking cost-reducing mechanisms away from intermediaries. In effect, trademark law would take intermediaries' marketplace-driven search cost reduction choices and give some of that decision-making power to trademark owners. There is no reason to believe that trademark owners would do a better job at search cost management than the marketplace; and there is some reason to believe that trademark owners would use their monopolistic powers to increase their wealth at the expense of everyone else in the chain.

This has socially significant consequences. If brand spillovers are trademark infringement, the result may be higher consumer search costs, which reduces economic welfare for everyone. This would be a counterintuitive result. We typically justify trademark law for its salutary effect on consumer search costs,¹³² but regulatory intervention here could produce the directly opposite result.

¹²⁸ See Eric Goldman, *Search Engine Bias and the Demise of Search Engine Utopianism*, 8 YALE J. L. & TECH. 188 (2006); Posting of Greg Linden to Geeking with Greg, *Marissa Mayer at Web 2.0*, Nov. 9, 2006, <http://glinden.blogspot.com/2006/11/marissa-mayer-at-web-20.html> (Google tried increasing the number of search results on the page but reverted the change because it had slightly slowed down page delivery).

¹²⁹ See Frank Pasquale, *Copyright in an Era of Information Overload: Towards the Privileging of Categorizers*, 60 VAND. L. REV. 135 (2007).

¹³⁰ The fact that keyword triggering presents ads rather than “editorially selected” search results is immaterial to this inquiry. Indeed, Google requires its ads to meet minimum quality and relevancy standards. See Google.com, *How are Ads Ranked?*, <http://adwords.google.com/support/bin/answer.py?answer=6111&topic=115> (discussing Google's “Quality Score for Ad Rank”).

¹³¹ See Brett M. Frischmann & Mark A. Lemley, *Spillovers*, 107 COLUM. L. REV. 257, 300 (2007).

¹³² See Stacey Dogan & Mark Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUSTON L. REV. 777 (2004)

CONCLUSION.

Technology exceptionalism is hardly new. In fact, during the early stages of a technology's adoption, exceptionalism is practically inevitable.¹³³ However, unwarranted technology exceptionalism can seriously distort policy-making, so each instance requires exacting scrutiny.

The reaction to keyword triggering appears to be a textbook case of misplaced exceptionalism. Retailers engage in indistinguishable behavior offline but their behavior has been completely immune from trademark scrutiny. Nevertheless, it has proven almost irresistible to characterize the Internet as somehow unique, special or different and overlook analogous well-settled offline rules.

This temptation may be understandable, but that does not make the results any less pernicious. Intermediaries can add value in the distribution chain by helping consumers reduce their search costs, and third party trademarks may provide an essential tool to facilitate that goal. As a result, preventing intermediaries from using third party trademarks as a merchandising aid hinders their ability to function as search cost reducers/managers. Everyone loses in this process—intermediaries, who become less valuable to consumers; consumers, who face increased search costs; and society as a whole, which suffers reduced wealth from the increased search costs.

¹³³ See Peter Huber, *Safety and the Second Best: The Hazards of Public Risk Management in the Courts*, 85 COLUM. L. REV. 277 (1985) (arguing that courts overreact to the risks of new technologies). [CITE]