Brand Spillovers
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Abstract: *A panoply of retailer practices, such as advertising loss leaders or marketing house brands, take advantage of third party trademarks to increase the retailer's profit. In a sense, trademark owners create spillover benefits for these retailers (I call these benefits "brand spillovers").*

This Article examines the phenomenon and legal treatment of brand spillovers. In general, retailers have not been held liable for capitalizing on brand spillovers. Yet, from a theoretical perspective, arguably retailers get a "free ride" from the positive externalities of brand spillovers. On that basis, perhaps trademark owners should be allowed to reinternalize those benefits. However, retailers' efforts also reduce consumer search costs, creating social benefits. Thus, it would be a mistake to constrain retailers from capitalizing on brand spillovers.

Like retailers, online intermediaries may use brand spillovers to reduce consumer search costs. As a result, search engines, adware vendors and other online intermediaries should be legally treated like retailers and not held liable for reducing consumer search costs.

INTRODUCTION

In a typical trademark enforcement campaign, a trademark owner pursues competitors and counterfeiters, but never retailers. Retailers appear to escape as the blameless bystanders in trademark disputes.

This is ironic because typically retailers are the power player in distribution chains. Far from being passive intermediaries, retailers control—and sometimes manipulate—consumer behavior to increase the retailers' sales.

Among other techniques, retailers routinely and actively capitalize on what I call "brand spillovers." A brand spillover occurs when a trademark owner generates consumer interest in a trademarked product but third parties (retailers or other manufacturers) capture additional revenue from this interest. This process has four steps:

1. A trademark owner promotes a trademarked offering.
2. This promotion instigates consumers to search for the trademarked offering.

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3. In the course of the consumer's search, retailers present other products to the consumer that compete with or complement the trademarked offering.

4. Consumers purchase these other products, creating incremental profits for the retailers (and perhaps third party manufacturers). Some of these purchases will be diversionary in that they replace sales of the trademarked offering; other purchases simply will be new purchases that are proximately attributable to the trademark owner's marketing efforts.

Retailers capitalize on brand spillovers in many ways, but retailer sales of "house brands"[1] provide a good illustrative example. Frequently, retailers offer house brands side-by-side with branded products, using evocative trade dress and comparative statements. Through the products' physical adjacency, consumers searching for the branded products see the house brand, which some of those consumers purchase instead of the branded products. In turn, house brands typically yields higher margins for the retailer than the branded products, so this brand spillover process increases retailers' profits.

Unquestionably, retailers "use" third party trademarks to generate these brand spillover benefits. Further, this "use" creates positive externalities for the retailers, giving retailers (and other manufacturers) a free ride on trademark owners' work. Arguably, then, such behavior might be appropriately sanctioned through doctrines like trademark infringement or unfair competition.

Yet, despite the ubiquity of retailer practices that capitalize on brand spillovers, my research has not yielded a single case where these retailer practices (without other defects, like confusing trade dress) have been deemed trademark infringement or unfair competition. In fact, there appears to be wide consensus that such retailer practices are normal and legitimate, and I have had difficulty finding cases where trademark owners even sued retailers at all.

In contrast, trademark owners have shown little reluctance suing online intermediaries, such as search engines and adware vendors, for activities that capitalize on brand spillovers. The legal treatment of online intermediary behavior is not yet settled, but some early precedents have been very unfavorable to the intermediaries.

There are several reasons why the law of physical product adjacency may not be extensible online, but this Article will provide a normative framework to explain that, in fact, retailers and online intermediaries perform identical functions for consumers of lowering consumer search costs. In turn, these transaction cost reductions improve consumer and social welfare, so it would be a mistake to attempt to reinternalize brand spillover benefits to trademark owners.

[Description of Parts].

I. BRAND SPILLOVERS IN RETAIL CONTEXTS

A. Retailers as Power Players in the Distribution Chain

Retailers are often assumed to be passive intermediaries between manufacturers and consumers. Typically, neoclassical economists assume that intense inter-retailer competition forces them to become passive agents for effectuating consumer demand, effectively making the retailers invisible in the distribution chain.

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[1] House brands are a retailer's generic version of a well-known branded product. House brands are also referred to as "store" brands or "private label" brands.

This assumption is wrong. Retailers are hardly passive intermediaries between manufacturers and consumers.

1. *Retailers' Leverage Over Manufacturers*

With respect to manufacturers, retailers often have significant leverage over manufacturers. Retailers control the manufacturer's access to consumers.[2] If the retailer decides not to carry the manufacturer's goods, the manufacturer may lose significant sales opportunities. As a result, in some retailing sectors, manufacturers "compete" to be carried by retailers.[3] Thus, large retailers like Wal-Mart or Costco can act as "king-makers;" their decision to carry a product can propel its manufacturer to a market leadership position, and their decision to drop a product can doom its manufacturer.

Also, retailer selling space is typically fixed in the short run, so retailers attempt to maximize its allocation to produce the highest return. Retailers' placement decisions affect manufacturer sales—eye-level placement generates more sales than placement on the bottom shelf; and placement in displays at aisle ends generates more sales than placement in the middle of aisles. Thus, competition for prime shelf space allows some retailers to charge manufacturers extra for certain types of placement. In some cases, retailers can charge "slotting fees" that do not vary with sales volume.

2. *Retailers' Control Over the Consumer Experience*

In many cases, retailers have substantial or complete control over the consumer's shopping experience. A retailer's goal is to generate more sales from each consumer, so retailers engage in a variety of techniques designed to change consumer behavior, such as positioning products to generate impulse purchases or to direct consumer interest in a way that maximizes sales.[4] Retailers are also notorious for seeking ways to increase the amount of time that consumers spend in their stores,[5] under the theory that consumer spending increases as a function of the time spent in store.

From a branding perspective, the retailer, not the manufacturer, has the direct front-line interaction with the consumer. Thus, the retailer's choices and behavior can significantly shape the consumer's perceptions of the brand. For example, retail salespeople can set consumer expectations and steer consumers towards or away from specific purchases. Other ways that retailers can affect consumer perceptions include:

- retailer advertising. Retailers frequently advertise manufacturers' products. In some cases, manufacturers provide "co-op" funds to retailers to defray the cost of such advertising (which partially benefits the manufacturer by stimulating demand for the manufacturer's products).

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[2] This becomes less true when the manufacturer sells direct-to-consumers. In some industries, direct sales to consumers are the norm. In other industries (such as groceries), they are the exception. In many cases, manufacturers' direct-to-consumers sales alienate retailers, who legitimately view such sales as a threat to the retailer's intermediation (a phenomenon sometimes called "channel conflict"). In response, retailers may weaken support for the manufacturer or drop the manufacturer altogether.

[3] Over 20,000 new grocery products are debuted each year. *See* Food Institute Report. However, a typical grocer adds only about Y new products each year. [CITE] [http://www.findarticles.com/p/articles/mi_go1545/is_200209/ai_n7194706 – 30,000 new products annually compete for total SKUs of 25,000 at average grocery store]

[4] A classic example is when grocers places children-oriented cereals on lower shelves—i.e., at eye level for children.

[5] [CITE]

- product placement within the store environment. As discussed further below, retailers communicate some information to consumers based on where the retailer places the products within the store. For example, consumer perceptions about a product might depend on the "department" it is housed in; such placement might help consumers recognize new and unexpected utility of the product.
- product bundling, Retailers can bundle multiple products together. For example, a retailer might combine a vodka bottle and a pack of cigarettes into an integrated "sin" package.[6]
- pricing/discounting. Similarly, retailers can shape consumer brand perceptions through pricing or discounting. For example, a retailer can "cheapen" a high-end brand through aggressive price discounting.[7] Retailers can also create synthetic product bundling through pricing strategies (such as "buy this product, get a different product free").

B. Intra-Store Spillovers

Trademark law typically focuses on the interaction between a senior user and a junior user, treating intermediaries like retailers as invisible players. The previous subpart told a different story—that manufacturers often cannot control their interaction with consumers because of retailer leverage over them and because retailers make choices (outside of the manufacturer's control) that shapes consumer perceptions and behavior.

This subpart extends this argument by showing how retailers actively and deliberately take advantage of manufacturers' brands to increase retailers' profits. There are a variety of ways that retailers use manufacturer brands to "move" consumers around within the retailer's store.

1. *Loss Leader*

To stimulate consumer traffic to the retailer's store, retailers often prominently advertise a well-known branded product at or below cost (a "loss leader").[8] While some consumers will purchase only the loss leader and no other products, other consumers will purchase products (from other brands or from the retailer's house brands) that generate profit for the retailer. In other words, with loss leaders, the retailer's advertisement of a trademark generates retailer profits from sales of products of other unrelated brands.

Loss leaders are regulated in a variety of ways:

- Some state laws restrict the sale of goods priced below cost.[9]
- Antitrust law may restrict predatory pricing designed to drive out competition.[10]
- Consumer protection laws may protect consumers from "bait and switch" practices.

However, I have not found any case where a retailer's promotion of loss leaders to generate customer traffic (and increase retailer profits) has created liability under trademark law.

2. *Shelf Space Adjacency*.

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[6] *See* Death Tobacco Inc. v. Black Death USA, 31 U.S.P.Q. 2d 1899 (C.D. Cal. 1993).
[7] This rationale supported the "Fair Trade Acts."
[8] *See* AMERICAN HERITAGE® DICTIONARY OF THE ENGLISH LANGUAGE (Fourth Edition 2000), http://www.bartleby.com/61/53/L0255300.html.
[9] [CITES]
[10] [CITES]

Retailers physically organize the products in their stores using proprietary taxonomies. Typically, retailers clump related products together (for example, grocery retailers may have one aisle for health-care products and another aisle for breads and baked goods). Retailers may also "merchandise" products by creating physical adjacencies of complementary products. For example, the retailer may put bread next to cheese. Retailers also decide how to arrange products within the taxonomy; some products get premium eye-level placement and others are relegated to the hard-to-see bottom or top shelf—decisions which affect both the retailer's profit and each manufacturer's sales.

Collectively, these retailer taxonomizing/merchandising choices can increase the likelihood of brand spillovers. The physical adjacency of a heavily-marketed brand and a competitive poorly-marketed brand gives extra consumer exposure to the poorly-marketed brand. For example, this is the basic principle behind retailer house brands. Typically, retailers do little independent marketing of the house brand. Instead, retailers expect spillover effects from consumers seeking cheaper alternatives to the heavily-marketed brands. In effect, the retailer capitalizes on the trademark owner's marketing efforts to profit from the sale of the retailer's house brand.

From a legal standpoint, retailers may be liable for the products they place on their shelves. Retailers are liable if their house brand's trademarks or trade dress infringes the competitive product's trademarks,[11] and retailers can be strictly liable if a retailed product infringes a competitor's trademark.[12] Also, some courts consider retailers' decisions about shelf store adjacency when assessing a junior user's liability under the multi-factor likelihood of consumer confusion test.[13]

However, a retailer's mere placement of competitive or house brand alternatives physically adjacent to branded products, without other defects, appears not to constitute trademark infringement by the retailer. This practice has survived legal challenges in offline cases,[14] and a few online cases have endorsed the offline practice in dicta as well.[15]

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[11] [CITE to retailers liable for house brand trade dress infringement]. The retailer's suppliers might also be liable for such infringement under contributory trademark infringement doctrines.

[12] Trademark infringement is a strict liability claim, so the retailer's scienter is irrelevant. *See* McCarthy §25.57.

[13] [CITE]

[14] *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).

[15] *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"); 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

3. *Trademark-Triggered Merchandising*

Retailers may suggest additional or complementary products to consumers based on a consumer's expressed interest in a product. This can occur both pre- and post-sale.

Prior to a sale, a retailer may explicitly redirect a consumer based on the consumer's expressed brand preferences. For example, a consumer may request a brand that the retailer does not carry, and the retailer may suggest comparable alternatives that are in stock. Or, a consumer may request a branded product that the retailer carries, but a retail salesperson may steer the consumer to a different brand (such as one paying a larger commission to the salesperson).[16]

Despite the ubiquity of these practices, I have been unable to find any offline cases suggesting that the retailer is liable for trademark infringement based on pre-sale redirections. Instead, retailer redirection to comparable alternatives seems to be a generally accepted practice.[17]

Following a sale, retailers may also use a consumer's purchase of a specific brand to trigger additional marketing for other products. A well-known example is Catalina Marketing's post-purchase coupon system[18] that can trigger coupons for competitive products based on a consumer's actual grocery purchases. Another example is Amazon.com's recommendations (by both email and a customized web page) of new products based on a consumer's prior purchases.[19] (I will discuss the special issues relating to online retailing later).

I have not been able to find a case involving brand-triggered post-sale merchandising. Most surprisingly (giving its ubiquity and prominence), I have not been able to find any lawsuit over the Catalina Marketing's trademark-triggered couponing system—no lawsuits against Catalina Marketing, any manufacturer purchasing a competitor's trademark, or any retailer deploying the system or selling keywords as part of the system.

C. Inter-Store Spillovers

This Article principally focuses on spillovers that take place within a retailer's store, but retailers also can capitalize on brand spillovers based on their store's physical location in relation to other stores. This subpart discusses inter-store brand spillovers.

1. *Mall Adjacency*

Traditionally, malls compose a mix of tenants that include one or more "anchor tenants" surrounded by a variety of stores offering non-competitive goods and services.[20]

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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]."); 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). *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.").

[16] This 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).

[17] *Compare* 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).

[18] http://www.catalinamarketing.com/retail_services/index.html.

[19] http://www.amazon.com/exec/obidos/tg/browse/-/13316081/102-0769054-8475359.

[20] *See* Malcolm Gladwell, *The Terrazzo Jungle*, NEW YORKER, Mar. 15, 2004, at 120.

An anchor tenant draws customers into the mall, either through a strong brand or heavy marketing expenditures. The other mall tenants benefit from the consumer traffic that the anchor tenant generates. Not only do these secondary tenants profit from the anchor tenant's brand spillover, but the mall operator profits as well from both from increased rents charged to the secondary tenants plus (typically) a share of tenants' revenues. I have not been able to find any cases against mall operators for creating (or benefiting from) these adjacencies or against secondary tenants due to the resulting brand spillovers.

2. *Store Clustering*

Similar to mall adjacency, a retailer may locate near another retailer to capitalize on customer spillover. Two examples of this behavior:

- *Car dealers*. Car dealers may locate in an auto mall or otherwise in close proximity. This has benefits both for consumers and dealers. For consumers considering multiple brands, dealership adjacency reduces the consumers' search costs.[21] From the dealer's standpoint, consumers seeking a specific brand (or attracted by heavy dealer advertising) might be tempted to check out competing models at dealers they see on the way to/from the destination dealer.[22]
- *Gas stations*. At highway pit stops, a gas station may induce drivers to pull off the freeway, either because the gas station does freeway-based advertising or has a brand that attracts customers. A free riding gas station may convert some of the drivers who exit the freeway in search of the destination gas station.

As with shelf space adjacency, retailers may be liable for their store location choices if they choose a trademark or trade dress that infringes,[23] and store proximity could influence that analysis. For example, numerous cases (most of the ones I saw were pre-Lanham Act) found unfair competition when a new store would open next to existing store and adopt similar names/trade dress designed to draw ("divert") the original store's customers.[24] However, I have not found any trademark infringement or unfair competition cases based solely on retailers' store clustering without the infringing trademark or trade dress, even if done intentionally to take advantage of spillovers.

D. Ambush Marketing

Ambush marketing occurs when marketers try to associate their products or services in consumers' minds with a major well-publicized event without the event sponsor's permission.[25]

Ambush marketing can occur with any well-publicized event, but it is most closely identified with sports events. A classic example occurs when an advertiser broadcasts a sport-themed advertisement during the Olympic Games without directly mentioning the Olympics. Not only does this ad upset competitors who have paid significant money to

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[21] *See* Gallo Motor Center Corp. v. Mazda Motor of Am., 204 F. Supp. 2d 144, 154 (D. Mass. 2002) ("A Mazda dealership in close proximity to several other dealerships promotes interbrand and intrabrand competition which ultimately reduces prices while expanding sales and service options").

[22] Car dealer co-location also may be a function of local zoning laws.

[23] Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763 (1992).

[24] *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).

[25] *See* Steve McKelvey, *NHL v. Pepsi-Cola Canada, Uh-Huh! Legal Parameters of Sports Ambush Marketing*, ENT. & SPORTS LAW., Fall 1993, at 5, 5 (defining ambush marketing as an attempt "to capitalize on the goodwill, reputation and popularity of a particular sport or sporting event by creating an association without the authorization or consent of the necessary parties").

become official (and often exclusive) Olympics sponsors, but the ad encourages consumers to transfer some of their positive thoughts/feelings about the Olympics to the advertiser.

These type of "virtual" brand spillovers will be discussed more in Part II, but for now, I would like to focus on brand spillovers in physical space. A variety of retailers benefit from brand spillovers due to major well-publicized events. For example, in connection with sports events, retailers may hawk related thematic (and even legitimately-acquired branded) merchandise on popular walking and driving routes to the venue. Further, other businesses indirectly benefit from geographical proximity to the venue, including local restaurants, hotels and parking venues.

I have not been able to find any cases finding that ambush marketing generally (i.e., without using the sport event's name or event sponsor's name) constitutes trademark infringement or unfair competition. If anything, there is an extensive literature lamenting that ambush marketing appears to lack any legal recourse.

The closest I could find to an ambush marketing trademark infringement case was *Toy Manufacturers of America v. Helmsley-Spear, Inc.*[26] In the *Toy Manufacturers* case, the plaintiff operated a major conference in defendant's facilities. Defendant also operated a competitive and similarly named conference during the same time period and in the same building. Further, the defendant used the building's security procedures to co-register attendees for the defendant's conference, and this procedure was confusingly similar to the plaintiff's registration procedure. This procedure was designed to increase spillover attendance at the defendant's conference, and presumably create a way for vendors to reach the same audience by paying defendant instead of the plaintiff. As a result, the court cited the conferences' physical proximity and temporal adjacency against the defendant as part of its multi-factor likelihood of consumer confusion. However, clearly the physical adjacency only a contributing factor to the broader infringing activity.

E. Why Retailer Capitalization on Brand Spillover Is Not Actionable

It should not be surprising that there is virtually no trademark jurisprudence against retailers for capitalizing on brand spillovers. As a matter of positive trademark law, any such lawsuits should fail.

In many cases, the retailers do not make the statutory requisite level of "use" under 15 U.S.C. §1127, which requires a retailer to place the trademark on the good's containers.[27] A retailer does not display any trademarks merely by establishing a physical adjacency.

To the extent that retailers provide a "service" instead,[28] I still believe that the lack of the trademark's display in connection with the physical adjacency means that the retailer is not making a trademark use in commerce.[29] One exception is loss leaders, where the

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[26] 960 F. Supp. 673 (S.D.N.Y. 1997).

[27] A trademark use in commerce occurs "on goods when…it is placed in any manner on the goods or their containers or the displays associated therewith or on the tags or labels affixed thereto…." 15 U.S.C. §1127

[28] [CITE to cases saying that retailers provide a service—this may be in McCarthy]

[29] A trademark use in commerce occurs in connection with a service "when it is used or displayed in the sale or advertising of services…" 15 U.S.C. §1127. The repetitive references to the word "use" creates some ambiguity, but the reference to "display" suggests that the consumer needs to "perceive" the reference. *See* Deregulating Relevancy; *see also* Widmaier; Barrett; Dogan/Lemley.

retailer, in fact, displays the trademark in its advertising. However, such advertising is excused under the trademark exhaustion/"first sale" doctrine.[30]

Even if the retailer makes a trademark use in commerce, in most cases consumers will not experience the requisite level of confusion about the product's source. Mere physical adjacency, without more, typically does little to communicate any information to consumers about the product's source. Further, to the extent that consumers have come to expect that retailers vend products from multiple manufacturers adjacently, consumers may be able to keep the respective product sources straight. Plus, when retailers display products with the trademark owner's branding undisturbed, consumers do not have any reason to misidentify the source from the trademark owner's intended understanding.[31]

Although this does not affect the legal analysis, it also should be noted that trademark owners may have significant disincentives to sue retailers. After all, as this Article has argued, retailers often have significant leverage over manufacturers. To the extent that retailers might retaliate against trademark owners for bringing suit, the manufacturers could lose access to their consumers and suffer significant sales drops accordingly. Thus, like any other lawsuits against one's customers,[32] a trademark owner's lawsuit has significant customer relations/business risks that may inhibit the filing of such suits.

II. AN ECONOMIC ANALYSIS OF BRAND SPILLOVERS

A. An Argument for Regulating Brand Spillovers

On the surface, there may be reasons to create some cost-shifting mechanism due to brand spillovers. First, from an equity perspective, retailers reap undeserved private benefits (a windfall) when they capitalize on brand spillovers.

Second, from an economic perspective, brand spillovers are a type of positive externality. When retailers capitalize on brand spillovers, they obtain private benefits (extra profits from redirected consumers) without bearing the associated private costs of stimulating that consumer demand. Accordingly, manufacturers may undersupply marketing because they do not internalize the full benefits of marketing,

Collectively, the equity and economic views could support an argument that retailers' capitalization on brand spillovers should be actionable. In that case, liability rules could allow manufacturers to internalize the positive externalities they create for retailers.

On its face, this argument may not be factually supportable because retailers purchase product from manufacturers either directly or indirectly through a distribution chain. This allows manufacturers to set its sales price to internalize any positive externalities. In that case, the retailer pays for the marketing that benefits it, and the manufacturer has gotten full compensation for its efforts.

The manufacturer-retailer pricing mechanism does not fully resolve this issue, however. First, as discussed in the prior Part, there are situations where the trademark owner and the retailer do not transact at all, such as store clustering or ambush marketing.

Second, some brand spillover effects are so indirect that the pricing mechanism may not adequately capture them. For example, it may be hard for manufacturers to set a price that captures the value from the retailers' post-sale merchandising. Manufacturers

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[30] McCarthy §25:41.

[31] [CITE to co-branding cases where display of trademark owner's brand overshadows junior user's use.]

[32] This argument has been made frequently in response to the lawsuits brought by the recording industry against file-sharers. *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.

also may not be able to recapture any spillover effects that accrue to competitive manufacturers with adjacent products. Also, as discussed above, retailers may have such leverage over manufacturers that the resulting price competition may prevent manufacturers from fully capturing the positive externalities they create for retailers.

Third, even if a manufacturer internalizes brand spillovers through the price, the manufacturer may face a downward spiral typical of competing with free riders. Consider, for example, the manufacturer's competition with a retailer's house brand. The manufacturer spends on advertising and incorporates those expenses into the price. Retailers present houses brands adjacent to the advertised brand, and some consumers opt for the cheaper house brand. As a result, the manufacturer must spread the advertising expense over a smaller volume. This may exacerbate the price differential between the manufacturer's product and the house brand, which may further reduce the manufacturer's sales base used to spread out the advertising expenses. Ultimately, this situation must reach some equilibrium—the manufacturer's advertising will successfully build strong enough brand loyalty that consumers will not divert to a cheaper option, or the manufacturer stops/reduces advertising, or sales of the entire product line drop off to the point where the retailer is better served by reducing the price differential between the house brand and the advertised brand.

Thus, brand spillovers might create uninternalized positive externalities for retailers even if retailers purchase products from manufacturers. In turn, retailers could be barred from intentionally capitalizing on these spillovers (or forced to pay manufacturers for them).

For example, because brand spillovers are inevitable every time retailers co-locate competitive or complementary products on store shelves, retailers could be legally stopped from making choices that would lead to such spillovers. In a sense, rather than allowing retailers to organize products "topically," retailers could be forced to select some other organizational taxonomy.

For example, retailers could offer products organized alphabetically by brand. For example, all of the products branded "Dole" could be located adjacently in the "D" section. This would significantly reduce the risk of brand spillovers, as consumers seeking Dole products rarely would be exposed to competitive and complementary products from other manufacturers. Instead, for truly brand-loyal customers, the consumer would be presented with all of the Dole products in a single location, making all of Dole's brand advertising pay off for Dole.

Although I think retailers rarely organize their products in this manner, media retailers (such as music and movie retailers) and some clothes retailers often organize their products alphabetically (at least, within certain broad topical classes). Also in some industries, it is not uncommon for independent retailers to sell only a single manufacturer's products.[33]

Alternatively, retailers could organize their products by price where all of the products offered at $0.99 could be grouped together. Thus, a consumer who had a reservation price of $0.89 for a can of garbanzo beans could look for the beans in the $0.89 section. If they were not there, the consumer could walk down the aisle towards lower-priced products until they were found (or until the search fails because the

[33] [Examples? I'm thinking of high-end appliances where sales and support are fairly technical/specialized.]

retailer’s price is higher than the consumer’s reservation price). [ANY EXAMPLES OF RETAILERS WHO ORGANIZE THEIR PRODUCTS PRIMARILY BY PRICE?]

Even if retailers were forced to use these alternative product organizational schemes (alphabetically or by price), some brand spillovers would still occur. Consumers would still experience “serendipitous discoveries” where product store shelf adjacencies cause consumers to identify and purchase products that were not part of the consumer’s brand-activated search. Ultimately, brand spillover cannot be fully eliminated in any store with heterogeneous brands.

Further, alternative product organizational schemes could create headaches for retailers. In the grocery context, some products require special equipment—some food needs refrigeration or freezing or periodic hydration. With more complex purchases (such as consumer electronics), there can be some benefits to having salespeople with extra knowledge about specific product classes rather than salespeople with diffuse/zero expertise. Therefore, retailers would find some economies of scale to creating some topical categories to take advantage of these shared services.

Nevertheless, it would be possible to prohibit retailers from intentionally capitalizing on brand spillovers if this were good social policy.

B. The Case Against Regulating Brand Spillovers

Such reinternalization would not be good social policy. Ultimately, legal allocations related to brand spillover capitalization dictate who controls retailer decision-making. Legal liability for capitalizing on brand spillovers reposes taxonomical control in trademark owners or regulators (such as the courts) instead of retailers. So, we might frame the question a different way: who is in the best position to decide how products will be presented to consumers?

From my perspective, regulators are clearly in the poorest position to manage the retailing process. Consumer and retailing practices vary extensively by industry, and these practices evolve constantly. Regulators cannot keep up with the complexity and evolution of these practices.

Retailers and trademark owners are both guided by profit motives, which is both good and bad. On the down side, both retailers and trademark owners have incentives to increase their surplus at the expense of consumer surplus. On the plus side, the profit motive means that the invisible hand will encourage retailers and trademark owners to respond rapidly to consumer needs.

As between retailers and trademark owners, retailers are more likely to make choices that improve social welfare. Trademark owners have incentives to squelch their competition, while retailers have incentives to diversify their product mix across multiple manufacturers.

Further, retailers’ choices affect consumer search costs. Retailers can reduce consumer search costs through more efficient product presentation and organization, or retailers can increase search costs by making it harder for consumers to find desired products. These lower consumer search costs immediately increase the consumer surplus from all transacting consumers. Reduced search costs also enable some transactions to become newly advantageous, expanding the market for both consumers and producers. Thus, retailer intermediation can increase social welfare by increasing the number of beneficial transactions.

To be clear, retailers can recapture some of the benefits from reduced consumer search costs through their prices. Some consumers will pay extra for "convenience." Further, retailers can take advantage of the costs consumers incur to compare prices and shop around. Loss leaders work precisely because consumers prefer to make only a single stop than to visit multiple retailers. As a result, loss leaders bring consumers in the door, where consumers will then pay market (or even supra-market) prices for other goods because multiple stops at other retailers is costly.

Nevertheless, retailers compete on their ability to reduce consumer search costs. Retailers have choices about how to organize their products, and consumers reward retailers for better organization through increased retailer loyalty (which may lead to increased prices) and additional transactions. These competitive pressures encourage retailers to optimize their taxonomies.

Therefore, distortions in retailers' editorial choices undercut their capacity to cater to their consumers. Liability for capitalizing on brand spillovers does just that, preventing retailers from optimizing.

III. VIRTUAL BRAND SPILLOVERS

Until now, this Article has focused on physical proximity/adjacency as the source of brand spillovers. I would now like to extend the analysis to consider brand spillovers that occur in virtual contexts.

The most obvious example is online keyword triggering. Both search engines and adware vendors treat a consumer's search keywords as communicating the consumer's interest, and they try to cater to that interest by displaying advertising that is putatively responsive to that interest. In particular, where the consumer uses a trademark as his/her search keyword, the search engines or adware vendor may display advertising for competitors.

Virtual brand spillovers are likely to increase over time. [discuss new keyword-driven technologies like implicit search]

This display of competitive advertising is a type of "virtual" brand spillover. The competitive advertising appears temporally proximate to the consumer's putative expression of interest in the brand—much like the consumer might see competitive brands on a store shelf at the same time. Further, in some cases, the display is also "physically" proximate. In the case of adware, the competitive ad might be displayed "over" the trademark owner's content. In the case of search engines, the competitive ad might be displayed adjacent to search results that contain content related to the trademark owner.

Collectively, through these adjacencies, the competitive advertiser hope consumers will redirect towards their products based on the consumer's search activities. To the extent these searches were initiated by consumers responding to brand marketing or acting on brand loyalty, the competitive marketers are hoping to capitalize on brand spillovers.

Online intermediaries that capitalize on brand spillovers try, in effect, to recreate the consumer experience of shopping in physical space. Through keyword triggering, where multiple windows are located on consumer's screen, these intermediaries can create the types of spatial adjacencies that consumers experience with store shelf adjacencies of multiple branded vendors or of store clustering (with multiple retailers located conveniently next to each other). Online intermediary, like the retailer, profits from this, typically by charging a CPC fee but in some cases through CPA.

The law of intermediating virtual brand spillovers has been mixed. [Discuss cases—WhenU cases, GEICO, American Blinds, JR Cigar. Discuss the import/implications of "use in commerce"]

Clearly the law of brand spillovers suggests that there are differences between physical and virtual brand spillovers. But are there? Or is the law of virtual brand spillovers just another example of irrational cyberspace exceptionalism?

First, in cyberspace, consumers may be confused about the source of advertising content (even if the consumers are not confused about the source of the advertised products). For example, in the adware cases, some empirical evidence suggested that consumers did not understand who was delivering the pop-up ads.[34] However, adware-delivered ads are not unique in this regard; consumer confusion about content source is an inherent problem with online searching. In theory, this confusion may increase consumer search costs as their search may be misdirected or they may assign the wrong level of cognitive authority to the content.

Second, in physical space, there are potentially significant search costs of physically moving from one location to another. Imagine, for a moment, if grocery stores organized their products alphabetically by brand, such that a consumer had to go from aisle-to-aisle to compare the price and specifications of a particular product across the multiple provider with disparate brands.

However, with the low search costs in online contexts, there seems to be even less reason to be concerned about brand spillovers.

The problem is that unknown competitors can use online brand spillovers to receive immediate consideration side-by-side. In theory, this is exactly the problem with the positive externality of brand spillovers. Trademark owners will have socially sub-optimal incentives to build brand goodwill where competitors can gain equal competitive footing without incurring commensurate costs.

On the other hand, the reduced search costs improve the overall operation of the marketplace mechanisms. The improved competitive environment benefits consumers by improving their ability to pick among competitors and by forcing competitors to improve quality and price.

Yet, for those trademark owners who are able to establish real brand loyalty, the availability of competitive offerings will not dissuade loyal customers from seeking them out. The degree of brand loyalty dictates the consumer's willingness to consider alternatives, so in part virtual brand spillovers merely eliminate trademark owners' ability to capture transactions from consumers with weak brand loyalty due to high search costs.

[More to come on this topic—especially about how online intermediaries reduce consumer search costs just like retailers do, except that the competitive forces driving online intermediaries to reduce search costs are even more powerful than they are for retailers]

CONCLUSION

With the positive externalities implicit in any brand spillover, it is unsurprising that some people view deliberately capitalizing on brand spillovers as unethical and even

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[34] Gator expert study.

parasitic. But these views reflect a decidedly trademark owner-centric view of the world and an incomplete cost-benefit accounting.

From a consumer-centric perspective, brand spillovers are an unambiguous win. Consumers without brand loyalty get greater choices with reduced search costs. Brand loyal consumers get the positive externality of reduced prices from the increased marketplace competition.