

## Posner on Beanie Babies

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Cuddly, stuffed toy animals and Richard Posner might seem a strange combination. But maybe not, for Posner has a soft spot for small animals (but not dogs) and in addition to being an ardent fan of monkeys, describes himself as “slavishly devoted” to his cat Dinah.<sup>1</sup> So what could be more fun for a judge who likes small animals, finds intellectual property a challenging area for economics, and views writing as a form of consumption, not work (unlike the rest of us), than authoring one copyright and three trademark opinions in a three-year period involving Ty’s pellet-filled plush toy animals called “Beanie Babies”? In the copyright case, Posner held that a collector’s guide containing photographs of every released Beanie Baby did not infringe the copyrights on Beanie Babies as sculptural works.<sup>2</sup> In the trademark cases, Posner found that (1) a seller of second-hand Beanie Babies using the business name Bargain Beanies and the domain name “bargainbeanies.com” did not violate the federal antidilution statute;<sup>3</sup> (2) the personal name rule (which requires that a personal name achieve “secondary meaning” before it will be protected as a trademark) did not apply to a toy camel named “Niles;”<sup>4</sup> and (3) there was insufficient evidence on likelihood of confusion to find that the mark “Screenie Beanies” attached to a soft stuffed toy animal used for wiping computer screens infringed Ty’s trademark for purposes of summary judgment.<sup>5</sup>

Not surprisingly, I find myself in complete agreement with the four decisions, since my views on copyright and trademarks are thoroughly intertwined with Posner’s after having jointly authored numerous articles and a book on the economics of intellectual property law. My intention here, therefore, is to look more closely at a fascinating economic and legal question that arises in the *Perryman* case: whether

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<sup>1</sup> Larissa Macfarquhar, *The Bench Burner: How Did a Judge with such Subversive Ideas Become a Leading Influence on American Legal Opinion?*, *The New Yorker* 78 (Dec 10, 2001).

<sup>2</sup> *Ty, Inc v Publications International Ltd*, 292 F3d 512, 516, 519, 522–23 (7th Cir 2002). This case also involved a trademark infringement claim that was not brought before the appellate court.

<sup>3</sup> *Ty, Inc v Perryman*, 306 F3d 509, 513–14 (7th Cir 2002).

<sup>4</sup> *Peaceable Planet, Inc v Ty, Inc*, 362 F3d 986, 990 (7th Cir 2004).

<sup>5</sup> *Ty, Inc v Sofibelly’s, Inc*, 353 F3d 528, 535 (7th Cir 2003).

a reseller of goods in varying conditions (or, for simplicity, “second-hand” goods, even though some of the goods may be in pristine or new condition) who uses the original trademark to identify and promote the goods it sells (for example, a seller of used Fords who advertises and promotes the goods as used “Ford” automobiles) can dilute the trademark on the original good.

Ty began selling Beanie Babies in 1993. Beanies were designed with minimal detail, used basic colors, were easy to pose, had a heart-shaped tag attached that indicated the Beanie’s name and birth date, and were priced in the \$5 to \$10 range. Ty obtained several federal trademark registrations for variations of the BEANIE BABY mark. The collectors’ craze for Beanies, however, did not begin until Ty retired the nine original Beanies in 1997. Although Ty has produced over 800 types of Beanies since 1993, its marketing strategy of producing each type in limited quantities helped transform Beanies from a commodity to a collectible and helped create a secondary market. As Posner explains:

Ty deliberately produces a quantity of each Beanie Baby that fails to clear the market at the very low price that it charges for Beanie Babies. The main goal is to stampede children into nagging their parents to buy the new Baby lest they be the only kid on the block who doesn’t have it. A byproduct (or perhaps additional goal) is the creation of a secondary market, like the secondary market in works of art, in which prices on scarce Beanie Babies are bid up to a market-clearing level.<sup>6</sup>

I would add free advertising and publicity as advantageous byproducts of Ty’s limited supply strategy, which generates news stories and word-of-mouth advertising about the “shortage” of newly released Beanies.

Today, second-hand Beanie Babies are sold on eBay.com and other websites. A glance at eBay.com reveals that a few “rare” Beanies sell for more than \$1000. Perryman started selling retired and used Beanies in the secondary market in 1997 under the business name “bargain beanies” and domain name “bargainbeanies.com.” After Perryman refused Ty’s request to stop using the term Beanies in both her business and domain name, Ty filed a lawsuit in 1999 alleging trademark infringement, unfair competition and dilution under the Lanham Act. Perryman argued unsuccessfully that the term Beanies was either a generic or descriptive term without secondary meaning and, therefore, she was free to use the term to identify her business and the products she sold.<sup>7</sup>

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<sup>6</sup> *Perryman*, 306 F3d at 512–13.

<sup>7</sup> *Ty, Inc v Perryman*, 2001 US Dist LEXIS 10303 at \*29–31.

The lower court found that Beanie Babies was a protectible mark, granted summary judgment in favor of Ty on the dilution claim and enjoined Perryman from using “BEANIE or BEANIES or any colorable imitation thereof . . . within any business name, Internet domain name, or trademark.”<sup>8</sup> On appeal, Posner reversed the dilution claim and vacated the injunction. Posner reasoned that:

[The resale or secondary] market is unlikely to operate efficiently if sellers who specialize in serving it cannot use “Beanies” to identify their business. Perryman’s principal merchandise is Beanie Babies, so that to forbid it to use “Beanies” in its business name and advertising (Web or otherwise) is like forbidding a used car dealer who specializes in selling Chevrolets to mention the name in his advertising.

Dilution, however, may still occur even if there are offsetting benefits in the operation of the secondary market in Beanies. Stated differently, the question still remains whether the benefits from finding dilution more than offset the harm imposed on the operation of the secondary market.

#### I. TRADEMARK DILUTION

Traditionally, trademark infringement requires a likelihood of confusion between the plaintiff’s (*A*) and defendant’s (*B*) marks. This follows from the basic rationale for trademark protection. Trademarks reduce search costs by providing consumers relevant information on attributes of goods and services they buy. Consider the trademark (or, equivalently, brand name) CREST for toothpaste. The information associated with the mark (e.g., favorable past experiences) would be compromised if another toothpaste manufacturer uses a trademark that is confusingly similar to the CREST mark. Instead of simply reaching for the toothpaste labeled CREST, a consumer would have to take the time and effort to read the fine print and inspect the packaging to make sure he was getting the Proctor & Gamble’s CREST and not another toothpaste with a confusingly similar mark. Higher information costs would also result, for example, if a firm called its mouthwash CREST because many consumers would believe that the mouthwash was manufactured by or connected to (e.g., an approved licensee of) Proctor & Gamble. Not only are consumers injured by a confusingly similar mark but so is the owner of the mark. Proctor &

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<sup>8</sup> See *Perryman*, 306 F3d at 510. The injunction also forbade Perryman from using the Beanie mark or colorable imitation in connection with non-Ty products.

<sup>9</sup> *Id.* at 513.

Gamble would have less incentive to invest in developing and maintaining its mark and producing consistently high quality toothpaste if another firm used a confusingly similar mark.

Dilution is different. Dilution starts with the assumption that there is no likelihood of confusion. Consumers correctly perceive, for example, that there is no connection between the company that manufactures Cartier watches and say a restaurant called Pizzeria Cartier. Yet Cartier jewelry is so well known that the pizzeria's use will create a mental association between the restaurant and the jewelry manufacturer that, in some circumstances, may dilute the selling power of the Cartier mark. Before we consider more carefully the harm from dilution, we first summarize briefly the federal dilution statute.

#### A. The Statute

The Federal Trademark Dilution Act of 1995<sup>10</sup> is now §§ 43(c) and 45 of the Lanham Act. The stated purpose of the statute is to protect famous marks against another firm using a substantially similar mark that is likely to cause dilution by blurring or tarnishment even though in the given context there is no likelihood of confusion or competition between the parties. According to the statute, blurring "impairs the distinctiveness of the famous mark" while tarnishment "harms the reputation of the famous mark."<sup>11</sup> Thus, a defendant cannot avoid liability for dilution (as it may be able to when liability turns on likelihood of confusion) by adding a disclaimer that it is in no way affiliated with, connected to or sponsored by the firm the owns the famous mark. In principle, therefore, dilution greatly expands the property rights accorded a trademark owner, because these rights no longer depend on showing a likelihood of confusion. These rights, however, are not absolute, for § 43(c)(3) includes three exceptions to dilution: fair use of a famous mark in comparative advertising and parodies; news reporting and news commentary; and noncommercial uses.<sup>12</sup>

Dilution requires that the plaintiff's mark be famous. Only then will the mark retain its source significance when encountered outside the usual context of the goods or services in which the mark is used. For example, if someone advertises its health club as the Rolls Royce of health clubs, it will be understood that the term "Rolls Royce" implies a very expensive and exclusive health club. The statute defines a

<sup>10</sup> Pub L No 104-98, 109 Stat 985, codified at 15 USC §§ 1125, 1127 (2000).

<sup>11</sup> See the revised subsections 43(c)(2)(B) and (C), Trademark Dilution Revision Act, Pub L No 109-312, 120 Stat 1730 (2006), to be codified at 15 USC § 1125(c)(2), that were enacted in 2006 in an act to amend the Trademark Act of 1946 with respect to dilution by blurring or tarnishment.

<sup>12</sup> 120 Stat at 1731.

famous mark as one that “is widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark’s owner.”<sup>13</sup> Dilution also requires that the defendant’s mark be substantially similar or even identical to the plaintiff’s mark. Since the plaintiff and defendant’s goods are often dissimilar (otherwise ordinary confusion is likely), substantial similarity is necessary for the defendant’s mark to call to mind the plaintiff’s mark.

#### B. The Economics of Dilution

Assume that a firm’s sales depend on its trademark in three ways. First, the firm’s trademark lowers information and search costs, which increase the demand for the firm’s product. This increase in demand will increase the price the consumer pays or the firm’s sales or both because the product becomes more valuable to consumers. Second, the firm’s trademark symbolizes its image or the “face” it presents to the public. This image will depend on the quality of the firm’s product, its advertising (including the reputation of celebrities who promote and use the product), the status, income and prestige of persons who consume the product, and so forth. The firm’s image also affects the position of its demand curve—the more favorable its image, other things the same, the greater its sales independent of the information economizing effect of trademarks. Firms aggressively try to protect their image, which suggests that a positive “image” is a valuable intangible asset that generates greater sales and profits. Indeed, marketing and sales personnel stress the connection between trademarks and image, not the reduction in information costs that is central to the economic approach to trademarks. Finally, some well-known trademarks generate licensing revenues to the firm. For example, famous clothing designers frequently license their marks for use in ancillary products, such as eyeglasses and perfume.

Equation (1) summarizes the roles of a firm’s trademark ( $T$ ) in providing information about the firm’s product and symbolizing its image.

$$(1) P = P_0 + \alpha I(T, z) + \beta M(T, z)$$

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<sup>13</sup> Id. Prior to the 2006 Act it was unclear whether fame in a niche market as opposed to fame to the public at large satisfied the “famous” requirement. From an economic standpoint, fame in the niche market could be sufficient, provided the defendant’s use focuses on a sufficient number of consumers in that niche market. See *Times Mirror Magazines, Inc v Las Vegas Sports News*, 212 F3d 157, 165 (3d Cir 2000) (holding that the district court did not commit error by characterizing a mark as “famous” because the mark bore a “high degree of distinctiveness” for a niche market in which both litigants operated).

In equation (1)  $P$  denotes the full price consumers are willing to pay for the good;  $P_0$  is the price if the firm provides no or minimal information about its product and has an image that contributes nothing of value (that is, a “zero” image);  $I$  denotes information the firm provides that reduces consumer search costs;  $M$  denotes the firm’s image, which adds value to its product when  $M$  is positive and subtracts value when  $M$  is negative; and  $\alpha$  and  $\beta$  transform units of information and image into dollars. We assume further that  $I$  and  $M$  are positive and decreasing functions of the strength of the firm’s trademark  $T$  and  $P$  is independent of the firm’s output  $X$ .<sup>14</sup> To be sure, other factors ( $z$ ) such as product quality, advertising and promotion, celebrities who use the product, newspaper stories, management scandals, and so forth also influence  $I$  and  $M$ , but here we focus on the role of trademarks and take as given the influence of all other factors.

We can write the firm’s net profits  $\pi$  as

$$(2) \pi = [P_0 + \alpha I(T, z) + \beta M(T, z)]X + L(T) - C(X, T)$$

where  $\pi$  includes revenue ( $L$ ) the firm expects from licensing its trademark and nets out the firm’s cost  $C$ . We assume that  $C$  is a positive and increasing functions of  $X$  and  $T$  (that is, marginal cost is positive and increasing in both  $T$  and  $X$ ). The firm will select values for  $T$  and  $X$  that maximize its profits, which yield

$$(3) [P_0 + \alpha I(T, z) + \beta M(T, z)] - C_x = 0$$

$$(4) (\alpha I_T + \beta M_T)X + L_T - C_T = 0$$

Equation (3) is the usual profit-maximizing condition that equates price (holding  $T$  constant) and marginal cost. Notice that the relevant price in (3) is the full price  $P$ , which will be higher, the greater the strength of the firm’s trademark (and, therefore, the lower the consumer search costs and the more favorable the firm’s image). From (3) it follows that the higher  $P$  is, the greater the firm’s output  $X$  will be. Equation (4) defines the firm’s optimal expenditures on its trademark. These expenditures will be greater, the greater the marginal product of its trademark in lowering search costs ( $\alpha I_T$ ), enhancing its image ( $\beta M_T$ ), and generating licensing revenues ( $L_T$ ). Note also that the equilibrium level of  $T$  will be greater, the greater the firm’s output (for the marginal gains  $\alpha I_T$  and  $\beta M_T$  are weighted by  $X$ ) and the lower the

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<sup>14</sup> We assume the firm is a price taker in the sense that the demand curve it faces is infinitely elastic at  $P_0$  but it can obtain a higher price as it provides more information and its image becomes more favorable. This model is essentially the one in William M. Landes and Richard A. Posner, *The Economic Structure of Intellectual Property Law* 174–79 (Belknap Press 2003), with the addition of the impact of the firm’s image and licensing revenues (both of which depend on the strength of the firm’s trademark) on revenues and profits.

marginal cost ( $C_T$ ) of developing and strengthening its trademark. The profit maximizing values of  $X$  and  $T$  are determined simultaneously since  $X$  depends on  $T$  and  $T$  on  $X$ .

In a typical trademark infringement suit, the plaintiff  $A$  must show that the similarity between  $A$ 's and the defendant  $B$ 's marks makes consumers likely to think that  $B$  is selling  $A$ 's brand (that is, passing off) or that  $A$  has sponsored, approved or licensed  $B$ 's product. In terms of equation (4), a likelihood of confusion reduces the information embodied in the  $A$ 's trademark (lowers  $\alpha$  or  $I_T$  or both), which leads  $A$  to reduce its expenditures on its mark. If  $B$ 's infringement is unchecked, consumer search costs will increase and  $A$  will receive a lower price for its product and reduce its output  $X$ .<sup>15</sup> Not only does infringement injure  $A$  but, on average, consumers are also injured because their search costs increase.  $B$ 's infringement may also harm  $A$ 's image (particularly if  $B$ 's product is of lower quality) and reduce  $A$ 's trademark licensing revenues, if  $B$  had licensed instead of infringed  $A$ 's mark.

Dilution is different. Although  $A$ 's and  $B$ 's marks are substantially similar or even identical, consumers are not confused with respect to source, sponsorship, affiliation, and so forth. Consumers correctly perceive that there is no connection between the two firms, notwithstanding the closeness of their marks (for example, consumers do not believe that a chain of health clubs called "The Cadillac Body Shop" is connected in any way to General Motors or Cadillac automobiles). The two principal injuries from dilution are blurring and tarnishment.

Blurring reduces the value of  $\alpha$  or the productivity of the plaintiff's mark in generating information about the firm's product because it takes consumers on average slightly more time and effort to connect  $A$ 's mark to its goods. For example, it might take consumers an extra millisecond to realize that a radio commercial promoting Cadillac automobiles is not a commercial for The Cadillac Body Shop. Blurring makes it more costly for consumers to obtain information from  $A$ 's mark, which translates into a lower  $\alpha$  or smaller savings in search costs. Consider the lawsuit brought by Ringling Brothers against the state of Utah that claimed the state's slogan "THE GREATEST SNOW ON EARTH" to promote winter tourism diluted the circus's famous trademark slogan "THE GREATEST SHOW ON EARTH."<sup>16</sup> Even assuming that consumers understand that there is no connection between Ringling Bros. and the state of Utah, Ringling Bros.' mark

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<sup>15</sup> See *id.*

<sup>16</sup> *Ringling Bros–Barnum & Bailey Combined Shows, Inc v Utah Division of Travel Development*, 170 F3d 449, 451–52 (4th Cir 1999).

could well provide a smaller reduction in search costs because it takes a consumer a little more time to figure out that the Ringling Bros. advertisement is promoting the circus, not the snow in Utah.<sup>17</sup> It is worth noting that for blurring to take place, there must be some overlap between consumers exposed to the Ringling Bros.' advertisements and to the state of Utah's advertisements. A rough proxy for such overlap is that the Ringling Bros. mark is famous or at least well known among persons exposed to the state's slogan. More formally, blurring lowers  $\alpha$  in equations (1) through (4) or the dollar savings in search costs, holding constant  $I$  and  $T$ . Blurring may also have a negative impact on incremental licensing revenues ( $L_T$ ) if the defendant was a potential trademark licensee. In equilibrium, blurring lowers the plaintiff's profit-maximizing expenditure on  $T$  in equation (3), raises consumer search cost and lowers the full price of the product ( $P_o + \alpha I + \beta M$ ) as  $\alpha$  and  $I$  fall).

Two other points about blurring are worth noting. Although blurring probably has a negligible impact on the added time and effort it takes a single consumer to correctly associate  $A$ 's mark with its good, the aggregate cost across a large number of consumers can be substantial. A related point is that a single firm's blurring of  $A$ 's mark may only impose a slight cost on consumers, but blurring by several firms can substantially increase overall search costs. In the limiting case, widespread blurring can transform  $A$ 's mark from a brand name to the generic name of the product. When this happens,  $A$  will have to invest resources in developing a new trademark. In terms of our model, extreme blurring means that  $A$ 's mark no longer provides valuable source information (that is,  $\alpha I(T) = 0$ ) or generates any image-related ( $\beta M(T) = 0$ ) or licensing ( $L(T) = 0$ ) revenues.

Dilution also occurs when  $B$  tarnishes  $A$ 's trademark. Here  $B$ 's use of  $A$ 's mark promotes an offensive or even detestable association with  $A$ 's mark. The clearest example occurs when  $B$  employs  $A$ 's mark in connection with pornography or sexually offensive material. For example, in the adult film "Debbie Does Dallas," the star performs sexual acts wearing a uniform "substantially similar" to the trademarked attire of a Dallas Cowboy cheerleader.<sup>18</sup> The movie contained no social commentary and potentially harmed the image (lowered  $\beta M(T)$  and  $L(T)$  in equation (2)) of the Dallas Cowboys and their

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<sup>17</sup> To simplify the model, we assume that blurring does not affect the firm's image  $M$  in equation (1). We note, however, the blurring will affect the firm's image because it leads the firm to choose a lower  $T$ . Since the firm's image  $M$  depends on the level of  $T$ , a lower  $T$  caused by blurring will also weaken the firm's image.

<sup>18</sup> See *Dallas Cowboys Cheerleaders, Inc v Pussycat Cinema, Ltd*, 604 F2d 200, 202-03 (2d Cir 1979) (noting the scene in question and some related advertising referencing Dallas Cheerleaders).



cheerleaders. Although the movie will not reduce the Cowboys' football revenues, it could reduce ancillary income generated by the cheerleaders. Another example of tarnishment involved Yardman's humorous advertisement that depicted John Deere's famous leaping male deer running in fear from a Yardman tractor and a barking dog.<sup>19</sup> The purpose of the ad was to gain sales, but in the process it tarnished the favorable associations consumers have with John Deere's mark. In terms of equation (2), tarnishment harms  $A$ 's image, which lowers  $\beta M(T)$  and  $L(T)$  and eventually reduces  $A$ 's profits per dollar expenditure on  $T$ . Note also that as  $M_T$  and  $L_T$  decline,  $A$ 's equilibrium expenditures on its trademark decline in equation (4).<sup>20</sup> Consumers are injured because tarnishment lowers the value (and hence consumer surplus) they receive from  $A$ 's image.

The relative impact of blurring and tarnishment on dilution will depend on the importance of search costs relative to image in the product's price. Generally, the more important status and prestige are in creating product value (holding information constant), the more important the firm's image will be, and the potential harm from tarnishment will be greater relative to the harm from blurring. Thus, luxury watches, fancy cars, designer clothing and expensive perfumes are at greater risk from tarnishment because their prices largely depend on image-type attributes. In contrast, blurring is likely to be of greater concern for trademarks attached to products whose prices are largely determined by production and distribution costs rather than image attributes.

A third possible cause of dilution, but one that is not actionable under the Lanham Act, resembles the common law tort of misappropriation. Here the defendant uses the plaintiff's famous mark where there is no risk of blurring or tarnishment. The plaintiff's harm arises from losing the option to license its mark. Imagine, for example, that a neighborhood fitness studio calls itself "Body by Tiffany." Assuming no chance of tarnishment or blurring, if Tiffany had the legal right to prevent the unauthorized use of its name, it might license the Tiffany name to the fitness studio. The prospect of additional licensing revenues will increase  $L_T$  in equation (4), increase Tiffany's incentive to invest in its already famous mark, and lead to a higher equilibrium level of  $T$ . But as Posner explains, these extra revenues are likely to be trivial.

The validity of the rationale may be doubted, however. The number of prestigious names is so vast (and, as important, would be even if there were no antidilution laws) that it is unlikely that the owner of a

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<sup>19</sup> See *Deere & Company v MTD Products, Inc.*, 41 F3d 39, 41 (2d Cir 1994) (describing the symbol and the allegedly infringing advertisement).

<sup>20</sup> Although our model separates blurring from tarnishment, there will be some cases where blurring may also tarnish  $A$ 's mark and where, at the outset, tarnishment may also blur  $A$ 's mark.

prestigious trademark could obtain substantial license fees if commercial use of the mark without his consent were forbidden despite the absence of consumer confusion, blurring, or tarnishment.<sup>21</sup>

The cost of licensing its trademark is another reason to doubt that Tiffany would gain much from the license. Aside from the direct cost of drafting the license, Tiffany would also incur the cost of monitoring compliance with the terms of the license. These costs are probably not small because they include expenditures to ensure that the quality of fitness services is consistent with Tiffany's image. Moreover, inadequate monitoring can be construed as a "naked license" that results in Tiffany's losing trademark protection for its mark.

Another possible category of dilution concerns a firm that lawfully sells a knock-off of a prestigious good and uses the latter's mark to inform (but not confuse) consumers about the product it is selling.<sup>22</sup> Consider a mail order firm that sells a cheap perfume whose scent is indistinguishable from Chanel No 5. Obviously, the most efficient (and maybe the only economical) way to inform consumers of this fact is to advertise that its scent is identical to Chanel No 5.<sup>23</sup> Since it is lawful to sell the imitation, a legal prohibition on using the Chanel mark to provide information would probably prevent the copier from doing what the law allows him to do; namely, sell cheap copies. From an economic standpoint, however, the copier has tarnished Chanel's mark. The ability of Chanel and other manufacturers of luxury goods to charge premium prices depends, in part, on their image of exclusivity and the status of the people who buy these goods.<sup>24</sup> As Chanel's fragrance becomes more commonplace, its prestigious image will decline, which reduces the number of people willing to pay a premium price for Chanel No 5. Ultimately, fashion-setters and wealthy women will shift to alternative exclusive perfumes, which will accelerate the decline in demand and downward pressure on the Chanel's price. In terms of our model, the sale of knock-offs will reduce the value of  $\beta M(T, z)$  for a given expenditure on  $T$  and lower the price that con-

<sup>21</sup> *Perryman*, 306 F3d at 512.

<sup>22</sup> See, for example, *Smith v Chanel, Inc.*, 402 F2d 562, 562-63 (9th Cir 1968).

<sup>23</sup> *Id.* at 567 ("A competitor's chief weapon is his ability to represent his product as being equivalent and cheaper. The most effective way . . . in which this can be done is to identify the copied article by its trademark or trade name.") (quotation marks omitted).

<sup>24</sup> See Gary S. Becker, William M. Landes, and Kevin M. Murphy, *The Social Market for the Great Masters and Other Collectibles*, in Gary S. Becker and Kevin M. Murphy, *Social Economics: Market Behavior in a Social Environment* 76 (Belknap 2000) ("[T]he demand for many classes of collectible objects is enhanced when consumers of these objects are rich, renowned for their achievements as entertainers, politicians, or businessmen, and even when they are notorious scoundrels."). See also generally Shahar J. Dilbary, *Famous Trademarks and the Rational Basis for Protecting "Irrational Beliefs"*, 14 *Geo Mason L Rev* 605 (2007) (providing a legal analysis of the phenomenon of "snobs" who are influenced by "persuasive branding").

sumers are willing to pay for the product. Although potential purchasers know whether they are buying Chanel No 5 or the knock-off, there may be confusion in the personal relationship market where persons wearing the imitation perfume will deceive others into believing they are members of a class of well-to-do and sophisticated consumers. This, however, is not the kind of confusion or tarnishment that trademark law seeks to eliminate.

An interesting variant of the cheap imitation problem is *Esercizio v Roberts*,<sup>25</sup> where Roberts sold a kit that allowed a hobbyist to build a Ferrari look-alike car for about \$8,500.<sup>26</sup> Although no one purchasing a Roberts kit believed he was getting a genuine Ferrari, the appearance of Ferrari look-alikes on the road could tarnish Ferrari's image for two reasons. First, some potential Ferrari customers and other drivers might notice that the look-alike did not perform up to the high standard of a Ferrari. These persons, however, will be unaware of or discount the possibility that they are observing an imitation and not a genuine Ferrari. Second, since there will be more Ferrari look-alikes on the road, the exclusivity and snob-appeal of the Ferrari design will decline, which lowers  $\beta M(T)$ . Although Ferrari's image is tarnished, it is not clear that consumers are injured. To be sure, the product's image has diminished, but so has its price. Moreover, wealthy and status-seeking consumers can shift to other exclusive automobiles and products. On the benefits side, people who buy knock-offs are better off, although this may come about from deception in the personal relationship market. There is an additional problem in the case of a high-status durable good as opposed to a perfume. Automobiles generate services today and in future periods whereas perfume primarily generates benefits in the current period. Owners of high-status durable goods, therefore, will suffer a capital loss on their stock of their goods from imitations, which will tarnish the image and hence reduce the value of the goods they own. In short, consumers are more likely to be injured in the case of high-status durable goods than perishable goods because the negative impact on the good's image will adversely affect consumers who already own the durable good.

It is worth noting one other situation that is special to the internet and could fit an expanded notion of dilution. Consider the Titleist trademark for golf equipment and balls. Only one party can use Titleist.com as its Internet name, whereas in real space many firms can simultaneously use the Titleist mark as a product identifier provided

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<sup>25</sup> 944 F2d 1235 (6th Cir 1991).

<sup>26</sup> Id at 1238. Although the court held that Roberts had infringed Ferrari's trademarks on the design of its automobiles, the underlying rationale for this result (as pointed out in the dissent) was that Roberts had tarnished Ferrari's image. Id at 1241-46, 1251-52.

there is no likelihood of confusion. A domain name is a private good in the sense that one firm's use precludes another from using the same domain name.<sup>27</sup> In contrast, an ordinary trademark has a public goods aspect to it since many firms can (in theory) use the same mark simultaneously without any firm's use preventing another firm's use. Prior to the passage of the Anticybersquatting Consumer Protection Act in 1999,<sup>28</sup> some people would register well-known marks as domain names and thereby preempt registration by the owner of those marks.<sup>29</sup> Known as cybersquatters, these people had no interest in exploiting the marks but instead hoped to sell or license them back to the firms that owned the marks in physical space. If negotiations failed, litigation might result in which the original trademark owner claimed dilution on the theory that the defendant's registration of the domain name lessened the capacity of the trademark holder to identify and distinguish its goods on the Internet.<sup>30</sup> This is a form of blurring because consumers would have to take more time and effort to connect the plaintiff's name to its website since the most obvious name was already taken by the cybersquatter. There is also the possibility of tarnishment because consumers might be directed to pornographic or other sites that injured the plaintiff's image. Tarnishment, however, would be rare because cybersquatters were banking the trademark, not using it for a commercial purchase.

## II. SECOND-HAND GOODS, TRADEMARK INFRINGEMENT, AND DILUTION

Beanie Babies are collectable items like art, coins, stamps, comic books, beer bottles, Star Wars action figures and so forth. A well-functioning second-hand market in collectibles depends on the availability to buyers and sellers of information on the types, condition and prices of products available, the terms of sale, the location of sellers and other relevant attributes of the products. In the case of Ty's Beanie Babies, this requires that the many second-hand dealers let potential customers know they are selling Beanie Babies or Beanie Babies and, in addition, provide information on the type of Beanie (for example, Batty the Bat, Princess Bear, or Halo the Angel), its age, and its condition. If a firm has substantial Internet sales, the most efficient way to provide

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<sup>27</sup> This is a slight exaggeration because the number of top level domain names is expandable—so a company could use, for example, titleist.biz if titleist.com were already taken.

<sup>28</sup> Pub L No 106-113, 113 Stat 1356 (1999).

<sup>29</sup> One such cybersquatter, Dennis Toepfen, registered over one hundred well-known business names such as Delta Airlines, Neiman-Marcus, Ramada Inn and U.S. Steel. See *Panavi-sion International, LP v Toepfen*, 141 F3d 1316, 1318–19 (9th Cir 1998).

<sup>30</sup> See *id.* at 1324–27.

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this information may include using the Beanie term as part of its business or domain name. As Posner explains:

[The secondary] market is unlikely to operate efficiently if sellers who specialize in serving it cannot use “Beanies” to identify their business. Perryman’s principal merchandise is Beanie Babies, so that to forbid it to use “Beanies” in its business name and advertising (Web or otherwise) is like forbidding a used car dealer who specializes in selling Chevrolets to mention the name in his advertising.<sup>31</sup>

Might a seller of second-hand goods like Perryman who disclaims any affiliation with the original manufacturer, infringe or dilute the trademark of the original manufacturer? Posner thinks not. “Perryman is not a competing producer of beanbag stuffed animals, and her Web site clearly disclaims any affiliation with Ty.”<sup>32</sup>

Dilution fares no better in Posner’s view:

Supposing that Perryman sold *only* Beanie Babies (a potentially relevant qualification, as we’ll see), we would find it impossible to understand how she could be thought to be blurring, tarnishing, or otherwise free riding to any significant extent on Ty’s investment in its mark.<sup>33</sup>

In Perryman’s case, Posner is clearly right. Since she is entitled to resell Beanies, she must be allowed to advertise that fact provided she does not claim that she is affiliated with or connected to Ty. But it does not follow that a reseller of Beanies in all circumstances should be allowed to use the Beanie mark in her advertising or business name. There are circumstances where such use would be socially harmful. Consider the following variation of Perryman’s situation.

Suppose a fire or flood has severely damaged a large number of Beanies in Perryman’s inventory. The damage includes tattered costumes, faces that are no longer recognizable and even limbs that have been torn from their bodies and destroyed. Assume further that the Beanies are sufficiently rare and valuable to make restoration worthwhile. In some cases, Perryman is able to work with the designation in both her business name and promotional material original materials; in other cases, she essentially starts from scratch but closely follows the original design. The end result is a restored Beanie that an expert cannot distinguish from a brand new one. Perryman promotes her goods as “restored and repaired authentic Beanies” in “like-new”

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<sup>31</sup> *Perryman*, 306 F3d at 512.

<sup>32</sup> *Id.* at 510–11.

<sup>33</sup> *Id.* at 512.

condition, and offers them at prices comparable to second-hand Beanies that have never been repaired. Perryman calls her business “Bargain Beanies” but disclaims any connection to Ty and provides on request a detailed description of her restoration work. In these circumstances, does Perryman risk infringing or diluting the Beanies’ mark by naming her firm “Bargain Beanies” and designating her goods as “authentic” and “restored Beanies”? Stated differently, can the extent of repair be so great that Perryman is no longer selling an authentic Beanie but a lower quality and possibly different product altogether? And at that point, Perryman would be no different than a producer of Beanie look-alikes who tried to pass off its goods as genuine Ty Beanie Babies.<sup>34</sup>

#### A. Trademark Infringement

Consider two groups of consumers. Group *A* consumers are not confused by Perryman’s use of the Beanie mark. They understand fully the extent of Perryman’s restoration and that she has no connection to Ty. At the same time, the Beanies confuse another group of consumers (group *B*) notwithstanding Perryman’s disclaimer. Some group *B* consumers may mistakenly believe that Perryman is a subsidiary of Ty or that Ty itself has restored the Beanies or authorized, sponsored or approved the restoration. Others in group *B* may significantly underestimate the extent of the restoration. For example, they might believe that restoration only involves minor sewing repairs and cleaning but not replacing damaged limbs and clothing. In short, mistaken beliefs could confuse and (as we show below) materially injure some consumers resulting in more harm than gain from letting Perryman use the Beanie mark to indicate a Ty product. Typically, however, this issue can be dealt with by requiring greater detail and clarity in the disclaimer not by removing the Beanie name.

Assume that new Ty Beanies sell for \$12; second-hand ones in like-new condition for \$10; and non-Ty Beanie look-alikes or knock-offs (which do not use the Beanie trademark) for \$6. Assume further that Perryman has 100 restored Beanies for sale at a price of \$10—the same price as the second-hand ones above. Suppose there are 1,000 customers (800 in group *A* and 200 in group *B*) currently in the market for second-hand Beanies. Persons in group *A* (the well-informed

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<sup>34</sup> The law, however, would permit the producer to use Beanies in a descriptive sense to inform consumers that it is selling a Beanie look-alike. (The Lanham Act lists a descriptive use of a mark as one of the defenses against infringement (§ 33(b)(4), codified at 15 USC § 1115(b)(4)) and dilution (§ 43(c)(3)(A), Pub L No 109-312, 120 Stat at 1731, to be codified at 15 USC § 1125(c)(3)(A)).

group) are willing to pay a maximum of \$6.00 for one of Perryman's restored Beanies because they view her product as equivalent to a Beanie look-alike without the Beanie trademark. In contrast, persons in group *B* (the misinformed group) are willing to pay up to \$10.00 each for Perryman Beanies because they view them as perfect substitutes for pristine second-hand Beanies that have never been damaged. Given these assumptions, Perryman has no trouble selling all 100 restored Beanies to group *B* consumers at a \$10 price. Suppose that over time, however, the 200 group *B* consumers acquire more accurate information about Perryman's extensive restoration and revise downward their valuations to \$6—the same value of a Beanie knock-off without the Beanie mark. At this point, group *A* and *B* consumers have identical valuations and the resale price of Perryman's restored Beanies in the collectibles market plunges 40 percent to \$6. Given these facts, has Perryman infringed the Beanie trademark by identifying her product as an authentic restored Beanie?

To be sure, consumers have lost \$400 (100 times the \$4 price decline) which they would have avoided if they had known earlier what they know now. Moreover, this is a real social loss, not a transfer, because the total value of Beanie collectibles has declined by \$400. What is less clear, however, is whether Perryman's use of the Beanie mark caused this injury. The answer is probably "yes." Group *B* consumers misinterpreted the combination of the Beanie mark in Perryman's business name and advertising, the term "authentic," the extent of the restoration, and her no affiliation disclaimer. As these consumers learned more about the true nature of Perryman's goods, they revised downward their valuations of her "Beanies" until they were worth no more than the \$6 or the market price of knock-offs without the Beanie mark. We also know that the Beanie trademark is worth \$6 because a new Ty Beanie sells for \$12 and a knock-off sells for \$6. Since the Ty Beanie and the knock-off are (by assumption) identical in all observable characteristics, the Beanie trademark is worth \$6 because it indirectly provides information on the high quality, prestige, and prior positive experiences of owning an original Ty Beanie. Perryman's calling her firm "Bargain Beanies" and claiming that her products are authentic Beanies is just like a manufacturer deceptively claiming his knock-offs or fakes are authentic Ty Beanies. The fake would initially sell for around \$12, but once the fraud was exposed its price would fall to \$6. Similarly, when Perryman passes off her product as an authentic Beanie in like-new condition, she can charge a \$4 premium above the price of a knock-off (equal to \$6 for the value of the Beanie mark minus \$2 for the fact that a new Ty Beanie sells for \$12 and a used one in like-new condition sells for \$10). In short, if Perryman were not permitted to use the Beanie trademark, consum-

ers would avoid a \$400 capital loss and would have greater confidence that the Beanie mark indicates an authentic Ty product that has not been extensively repaired.<sup>35</sup>

This, however, is not the end of the story. Consider the following possibility: Perryman continues to use the Beanie mark but provides a clearer description of her restoration (for example, she prominently discloses in her advertising that she has extensively restored and repaired the damaged Beanies) and deletes the term “authentic” from her promotional material. Suppose that Perryman makes these changes at a cost of \$50 (or \$.50 per restored Beanie), and as a result 150 of the 200 consumers in group *B* (the group misled earlier) now understand the true nature of Perryman’s restoration and that she has no connection to Ty. In effect, these 150 consumers are now part of group *A* (the informed group). There are still fifty persons in group *B* who continue to be misled by Perryman’s use of the Beanie mark, but since Perryman has 100 to sell, she can only clear the market by cutting her price to \$6 in order to induce fifty persons in group *A* (or fifty in *A* who were formerly in *B*) to purchase her product. At this point, Perryman’s deletion of the term “authentic” and her clearer disclaimer (at a cost of \$50) eliminates the \$400 harm to consumers—indeed, there may be some small gain from Perryman retaining the Beanie mark because it lowers the search cost of consumers who have a slight preference for a Perryman Beanie (with the Beanie mark) than a knock-off without the Beanie mark.

On the other hand, if Perryman’s changes induce only fifty, not 150, *B*’s to change their views of Perryman’s product, then Perryman will still be able to sell all her restored Beanies at a \$10 price. Assuming the 150 *B*s who were misled initially eventually understand the full nature of Perryman’s activity, the price will again fall to \$6 and cause a social harm of \$400. In this case, there is no gain to consumers from the additional \$50 Perryman spends on her disclaimer and the more efficient solution would be to hold her liable for trademark infringement and require her to remove the Beanie mark.

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<sup>35</sup> An additional complication that strengthens the argument for removing the Beanie mark from Perryman’s goods is that group *B* consumers may take account of the probability that the market will eventually view a second-hand Perryman Beanie as equivalent to a knock-off. This will lead them to discount the price they are willing to pay for a Perryman Beanie at the outset. At the same time, it may cause them to discount the price of other used Beanies sold by retailers because they have no reason to believe that one sold by Perryman is different from one sold by another retailer. In effect, Perryman’s has reduced the implicit value of the Beanie mark to other firms that sell second-hand that had not been severely damaged and then restored.



## B. Dilution

In addressing the question of dilution, we assume that consumers in both groups *A* and *B* understand the full nature of Perryman's repairs and restoration and her lack of any connection to Ty. Although Perryman uses the Beanie mark to identify her product and business, there is no consumer confusion and hence no trademark infringement. At the outset, Perryman's restored Beanies sell for \$6 (the same price as a knock-off without the Beanie mark) and there are no subsequent downward price revisions because consumers are already fully informed. Given these assumptions, can Perryman's actions blur or tarnish the Beanie mark?

Blurring is a remote possibility. One might claim that Perryman's use of the Beanie mark causes potential purchasers of Beanies to spend a little more time and effort to figure out whether the term Beanie refers to a new or a second-hand Beanie that had never been restored or a Perryman Beanie. Conceivably, this might reduce the productivity of Ty's advertising and promotion expenditures and increase consumer search costs. There is an offset, however, in another dimension of search costs: namely, the costs to consumers of distinguishing between a Perryman Beanie and a knock-off that does not use the Beanie mark. When Perryman uses the Beanie mark, these costs would be lower than when she removes the mark. In the latter situation, some consumers would incur the added search costs trying to figure out whether a product is a knock-off or a Perryman Beanie.<sup>36</sup>

Tarnishment seems even less likely than blurring. Consider the following example. Suppose a Perryman Beanie does not perform as well as a second-hand Beanie that never required any restoration. For example, a Perryman Beanie may be more likely to lose its shape or leak pellets or more likely to deteriorate over time than other second-hand Beanies. Would this tarnish Ty's image? Not likely, because consumers probably expect Perryman's Beanies to be of lower quality since they sell for 40 percent less (\$6 compared to \$10) than undamaged Beanies.

Two related points are worth noting. The first one starts with the (unlikely) assumption that a Ty Beanie is a prestigious and exclusive good whose image might be tarnished by a large number of cheap imitations or knock-offs. Since a Perryman Beanie is like a knock-off (as indicated by their identical prices of \$6), the more Perryman Bean-

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<sup>36</sup> It might appear that there are no consumer benefits from distinguishing between a Perryman Beanie and a knock-off given our assumption that both sell for the same price (\$6). This ignores the potential gain to inframarginal consumers who value the Perryman's goods at more than \$6. The source of this gain is the value some consumers attach to the fact that Perryman's goods are a mixture of a Ty Beanie and non-Ty replacement parts.

ies there are in the marketplace, the less exclusive the Beanie mark and the lower the price that consumers would be willing to pay for a new Ty Beanie. In this example, Beanies are like Porsche automobiles or designer clothes in that the willingness of consumers to pay high prices for these goods is compromised by a large number of cheap imitations. The harm to Ty's image, however, results from the large number of cheap imitations and knock-offs, not Perryman's use of the Beanie mark. Even if Perryman removed the Beanie mark, her goods would still add to the number of knock-offs. Hence tarnishment depends on the number of goods Perryman sells, not on whether they are marketed under the Beanie name.

The second and more plausible case for tarnishment arises because of subsequent resales of Perryman's Beanies. Although direct purchasers of Perryman's Beanies are, by assumption, fully informed about Perryman's repairs, persons who subsequently acquire these Beanies will probably not have this information. If it turns out that Perryman's Beanies are in fact less durable, this can tarnish Ty's image. There is no reason, however, to expect Perryman's Beanies to be less durable than a second-hand Beanie that has not been restored. Indeed, the opposite is more likely to be true since Perryman's Beanies have already undergone significant restoration that experts have praised.