

KIRKLAND ALERT

March 2014

Supreme Court Settles Circuit Split on Lanham Act False Advertising Standing

Lexmark International v. Static Control Components
Case No. 12-873, 572 U.S. ____ (2014)

Section 43(a) of the Lanham Act provides that a plaintiff may assert a cause of action for false advertising if he or she “believes that he or she is or is likely to be damaged by such act.” Despite this guiding language, circuit courts have employed a wide range of tests with differing standards to determine standing in false advertising cases, resulting in inconsistent outcomes. On March 25, 2014, the U.S. Supreme Court resolved the split among the circuits, holding that a false advertising cause of action under the Lanham Act extends to plaintiffs who fall within the “zone of interests” protected by that statute and whose injury was proximately caused by a violation of that statute.

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I. BACKGROUND

Petitioner Lexmark manufactures and sells laser printers as well as toner cartridges that are compatible exclusively with its printers. Lexmark’s competitors include remanufacturers who acquire used cartridges and refurbish them. To counter that, Lexmark implemented a “Prebate” program whereby customers received a 20-percent discount on new toner cartridges if they agreed to return the cartridge to Lexmark once it was empty. Each Prebate cartridge also contained a microchip that disabled the cartridge when the toner was used up. Because the microchip could only be replaced by Lexmark, the Prebate cartridge could not be resold by the remanufacturers. Respondent Static Control worked around this process by developing a microchip that could mimic the microchip in the Prebate cartridges. Static Control sold its microchips to remanufacturers, who used them to refurbish the Prebate cartridges.

After instituting its Prebate program, Lexmark sent letters to remanufacturers stating that it was illegal to sell refurbished Prebate cartridges using Static Control’s products. Lexmark also sued Static Control, alleging violations of copyright law. Static Control filed counterclaims alleging that Lexmark’s statements regarding the legality of refurbishing Prebate cartridges were false and misleading in violation of Section 43(a) of the Lanham Act. In particular, Static Control alleged that Lexmark’s misrepresentations proximately caused economic injury by diverting sales and reputational injury.

The district court dismissed Static Control’s false advertising claim, ruling that Static Control lacked standing based upon a multifactor balancing test set forth by *Associated General Contractors of California v. California State Council of Carpenters*, 459 U.S. 519 (1983). The Sixth Circuit reversed, instead adopting the Second Circuit’s “reasonable interest” test. The Supreme Court granted certiorari to determine

what the applicable standard should be for assessing standing under the Lanham Act.

II. CIRCUIT SPLIT: STANDARDS USED

The circuit courts had developed three different tests to determine whether a false advertising plaintiff has standing under the Lanham Act:

1. The Third, Fifth, Eighth and Eleventh Circuits implemented a multifactor balancing test assessing the following *Associated General Contractors* factors: (1) the nature of the plaintiff's alleged injury; (2) the directness or indirectness of the asserted injury; (3) the proximity or remoteness of the party to the alleged injurious conduct; (4) the speculativeness of the damages claim; and (5) the risk of duplicative damages or complexity in apportioning damages.
2. The Seventh, Ninth and Tenth Circuits relied on a categorical test, which only permitted direct competitors to bring a cause of action under the Lanham Act.
3. The Second and Sixth Circuits used the "reasonable interest" test, which was the most lenient and conferred standing if the claimant has a reasonable interest and a reasonable basis for believing that the interest is likely to be damaged by the false advertising.

III. SUPREME COURT'S DECISION

On behalf of a unanimous Court, Justice Scalia rejected all three tests that had been used to determine standing by the circuit courts. First, for the multifactor balancing test, Scalia noted that "open-ended balancing tests can yield unpredictable and at times arbitrary results." Second, Scalia criticized the categorical test as "distorting the statutory language" since the "common-law tort of unfair competition was understood not to be limited to actions between competitors." Third, Scalia objected to the "reasonable interest" test because it "lends itself to widely divergent application" and the reasonableness of plaintiff's interest or claim of harm is immaterial to analyzing standing under the Lanham Act.

Rather, the Supreme Court held that a two-part test should be employed to determine whether a statutory cause of action extends to certain plaintiffs: (1) the plaintiff must have an interest that falls within the "zone of interests" protected by the Lanham Act; and (2) the plaintiff's injuries must be proximately caused by violations of the statute.

(A) ZONE OF INTERESTS

In the context of a false advertising case, the Supreme Court held that "a plaintiff must allege an injury to a commercial interest in reputation or sales" to "come within the zone of interests" of the Lanham Act. This is squarely in line with the "Act's goal of protecting persons engaged in commerce against unfair competition," where unfair competition was associated with injuries to business reputation and

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present and future sales. As such, the Supreme Court found that Static Control's alleged economic and reputational injuries were "precisely the sorts of commercial interests the Act protects" and thus "fall within the zone of interests protected by the [Lanham Act]."

(B) PROXIMATE CAUSE

As a general rule, the Supreme Court held that "a plaintiff . . . ordinarily must show economic or reputational injury flowing directly from the deception" caused by the allegedly false statements, which "occurs when deception of consumers causes them to withhold trade from the plaintiff." The Supreme Court, however, recognized that "although diversion of sales to a direct competitor may be the paradigmatic direct injury from false advertising, it is not the only type of injury cognizable under [the Lanham Act]."

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As applied to Static Control, the Court mentioned two other situations that give rise to injuries cognizable under the Lanham Act, thus satisfying proximate causation. First, the Court held that "[w]hen a defendant harms a plaintiff's reputation by casting aspersions on its business, the plaintiff's injury flows directly from the audience's belief in the disparaging statements," thus satisfying the proximate cause requirement. Here, the Court considered the alleged statements made by Lexmark to the remanufacturers, namely that Static Control's business and products were illegal, and held that where a plaintiff "claims reputational injury from disparagement, competition is not required for proximate cause . . . even if the defendant's aim was to harm its immediate competitors, and the plaintiff merely suffered collateral damage."

Second, the Court held that proximate cause can also be satisfied if "the injury alleged is so integral an aspect of the violation alleged" such that there is no need for any "speculative proceedings" or "intricate, uncertain inquiries." Relying on Static Control's allegations that its microchips were both necessary for and had no other use than refurbishing Lexmark toner cartridges, the Court reasoned that although there is no direct causal chain between consumer confusion or deception and Static Control's injuries, the intervening link of injury to the remanufacturers does not break the causal chain. In other words, because the sales of Static Control's microchips are directly tied to the sales of refurbished Prebate cartridges by the remanufacturers, Static Control's loss in sales caused by Lexmark's false advertising would equal the remanufacturers' loss in sales. The Court therefore held that proximate cause had been satisfied by Static Control.

IV. CONCLUSION

The Supreme Court's decision in *Lexmark* sets forth a new, uniform standard for determining whether a plaintiff can invoke a cause of action for false advertising under the Lanham Act, and settles the long-standing tension between the circuits. Under this standard, a plaintiff must prove "an injury to a commercial interest in sales or business reputation proximately caused by the defendant's misrepresentations."

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