Lexmark v. Static Control: Supreme Court Concludes That False Advertising Plaintiffs Need Not Be Direct Competitors

by David R. Todd

On March 25, 2014, the U.S. Supreme Court issued its decision in *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, addressing who may sue for false advertising under the federal Lanham Act. Some Circuits, including the Tenth Circuit, had previously held that only direct competitors could sue for false advertising. The Supreme Court held that a plaintiff need not be a direct competitor in order to have a cause of action for false advertising although it is likely to be more difficult for such a plaintiff to qualify.

Lexmark manufactures and sells laser printers, as well as toner cartridges for those printers. Other businesses, called "remanufacturers," acquire used Lexmark cartridges, refurbish them, and sell them as replacement cartridges. The remanufacturers compete with each other and with Lexmark, who also sells refurbished cartridges in addition to new replacement cartridges. At one point, Lexmark began including a microchip in each of its new cartridges that would disable the cartridge after it ran out of toner. This made it more difficult for the remanufacturers to refurbish those cartridges. Static Control is not a remanufacturer, but it provides components to the remanufacturers necessary to allow them to refurbish cartridges, such as toner and other cartridge parts. Significantly, Static Control developed a microchip that allows the remanufacturers to bypass Lexmark's microchip.

Static Control alleges that Lexmark told end users of refurbished cartridges that they were contractually bound to return used cartridges to Lexmark, not remanufacturers. Static Control also alleges that Lexmark sent letters to remanufacturers asserting that it was illegal to sell refurbished cartridges and, in particular, to use Static Control's products to refurbish cartridges. Static Control alleges that these statements were false, that they misrepresented the nature of Static Control's products, and that these misrepresentations had caused and were likely to further cause loss of sales and injury to its reputation by leading those in the business to believe that Static Control "is engaged in illegal conduct." Thus, when Lexmark sued Static Control for violations of the Copyright Act and the Digital Millennium Copyright Act, Static Control counterclaimed for false advertising under the Lanham Act.

The district court dismissed the counterclaim on grounds that Static Control was not the type of plaintiff that was allowed to sue for false advertising under the Lanham Act. On appeal,

the Sixth Circuit reversed, concluding that Static Control was a proper plaintiff. The Supreme Court granted certiorari because the Circuits had adopted at least three different tests for addressing this issue.

The Lanham Act provision at issue states:

> (1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any…false or misleading description of fact, or false or misleading representation of fact, which—
>
> …
>
> (B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action***by any person who believes that he or she is or is likely to be damaged by such act***.

15 U.S.C. § 1125(a) (emphasis added). Static Control alleged that Lexmark had made false mispresentations "in commercial advertising or promotion" about the "nature, characteristics, [or] qualities" of Static Control's goods and that it "is or is likely to be damaged by such act."

Justice Scalia, writing for a unanimous Court, explained that read alone, the broad language of section 1125(a) "might suggest that an action is available to anyone who can satisfy the minimum requirements of Article III." However, the Court concluded that such a conclusion would be incorrect in light of two "background principles": (1) "a statutory cause of action extends only to plaintiffs whose interests 'fall within the zone of interests protected by the

law invoked'" and (2) "a statutory cause of action is limited to plaintiffs whose injuries are proximately caused by violations of the statute."

The Court then proceeded to analyze each of these two principles. As for the "zone of interests" protected by the Lanham Act, the Court noted that the Act itself contains a detailed statement of its purposes. In relevant part, it provides: "The intent of this chapter is…to protect persons engaged in [commerce within the control of Congress] against unfair competition…." 15 U.S.C. § 1127. The Court explained that at common law, "unfair competition" was "concerned with injuries to business reputation and present and future sales." Therefore, the Court concluded, "to come within the zone of interests in a suit for false advertising under § 1125(a), a plaintiff must allege an injury to a commercial interest in reputation or sales." As the Court pointed out, this means that *consumers* misled by false advertising do *not* have a cause of action under § 1125(a).

The Court then analyzed the proximate cause issue. "The question," according to the Court, "is whether the harm alleged has a sufficiently close connection to the conduct the statute prohibits" or whether the alleged harm is "'too remote' from the defendant's unlawful conduct." Ordinarily, a harm is "too remote" if it is "purely derivative" of harm to a third person caused by the defendant's acts. But in false advertising cases, almost every injury within the zone of interests will be, in a sense, one that is derivative of injuries suffered by consumers who are deceived by the advertising. Therefore, "the intervening step of consumer deception is not fatal to the showing of proximate causation required by the statute." As such, the Court declared, "a plaintiff suing under § 1125(a) ordinarily must show economic or reputational injury flowing directly from the deception wrought by the defendant's advertising" and that occurs "when deception of consumers causes them to withhold trade from the plaintiff." Significantly, the proximate cause showing is generally *not* satisfied "when the deception produces injuries to a fellow commercial actor that in turn affect the plaintiff." The Court provided examples in which the proximate cause showing would and would not be satisfied: "For example, while a competitor who is forced out of business by a defendant's false advertising generally will be able to sue for its losses, the

same is not true of the competitor's landlord, its electric company, and other commercial parties who suffer merely as a result of the competitor's 'inability to meet its financial obligations.'" The Court observed that "a plaintiff who does not compete with the defendant will often have a harder time establishing proximate causation," but "a rule categorically prohibiting all suits by noncompetitors would read too much into the Act's reference to 'unfair competition.'"

In adopting this two-pronged analysis, the Court noted that it was rejecting all three of the various tests that had been adopted by the Circuits. Some Circuits had adopted a multi-factor balancing test. Some Circuits had adopted a bright-line rule that only direct competitors could sue. And some Circuits, including the Sixth Circuit in this case, had adopted the so-called "reasonable interest" test.

The Court then applied its analysis to the facts of the case and concluded that Static Control was "within the class of plaintiffs whom Congress authorized to sue under § 1125(a)." As to the relevant "zone of interests," the Court concluded that Static Control's alleged injuries (lost sales and damage to its business reputation) "are injuries to precisely the sorts of commercial interests the Act protects." Then, even though Static Control is not a direct competitor of Lexmark, the Court found that Static Control's allegations were sufficient to satisfy the "proximate cause" requirement for two reasons. First, although Lexmark competes with remanufacturers and not directly with Static Control, Lexmark allegedly made false and disparaging assertions directed at Static Control's products. The Court explained that "when a party claims reputational injury from disparagement, competition is not required for proximate cause" and that this is true "even if the defendant's aim was to harm its immediate competitors." Second, according to Static Control's allegations, its microchips were "necessary for" and "had no other use than" refurbishing used Lexmark cartridges, and therefore "there is likely to be something very close to a 1:1 relationship between the number of refurbished [Lexmark] cartridges sold (or not sold) by the remanufacturers and the number of…microchips sold (or not sold) by Static Control." Therefore, false advertising that reduced the remanufacturers' business would be a proximate cause of a corresponding

reduction of Static Control's business. Earlier in its opinion, the Court had warned that the proximate cause showing "is generally *not* made when the deception produces injuries to a fellow commercial actor that in turn affect the plaintiff." But the Court explained that the reason for that general rule is that "there ordinarily is a 'discontinuity' between the injury to the direct victim and the injury to the indirect victim, so that the latter is not surely attributable to the former (and thus also to the defendant's conduct), but might instead have resulted from 'any number of other reasons.'" That reason is not applicable in the "relatively unique circumstances" alleged here, the Court concluded, because the allegations establish that fewer sales by Static Control would "follow more or less automatically" from fewer sales by the remanufacturers.