The Coverage Inkwell

Emerging Coverage Issues in Intellectual Property, Privacy, and Cyber Liability

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BREACH OF CONTRACT EXCLUSION DOESN'T BAR COVERAGE FOR COPYRIGHT INFRINGEMENT

Intellectual property invests its owners exclusive rights that are protected by federal and common law. Federal protection of such rights, for instance, are derivative of Article I, section 8, clause 8 of the United States Constitution (sometimes known as the "Intellectual Property Clause" or "Progress Clause"), which endows the Congress with the authority "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

When licensing or commissioning intellectual property, therefore, parties are careful (usually) to specify who retains ownership of the intellectual property and its exclusive rights. Such agreements also contain contractual provisions prohibiting the infringement of the intellectual property—usually materializing in use that exceeds the scope of the license, or continued use after the license has expired.

Strictly speaking, insurance policies do not provide coverage for breach of contracts. So, what happens when an insured, having entered into a contract involving intellectual property, infringes the intellectual property in violation of both the agreement and intellectual property law? Does a policy exclusion barring coverage for a breach of contract govern and prohibit coverage where coverage might otherwise exist? In *Looney Ricks Kiss Architects, Inc. v. State Farm Fire & Casualty Company*, -- F.3d --, 2012 WL 1109058 (5th Cir. Apr. 4, 2012), the Fifth Circuit addressed this question. (A shout-out to Craig Brewer at Staines & Eppling in Louisiana for the heads up about this case.) Analyzing two separate tests to determine the affect of the exclusion, the court, somewhat surprisingly, answered the question in the negative.

In *Looney*, the underlying action alleged that the insured, Steve Bryan and affiliated building companies (collectively, Bryan), infringed the copyright of plaintiff's architectural designs in violation of a prior agreement entered into between the parties. The plaintiff, Looney Ricks Kiss Architects, Inc. (LRK), had designed the Island Park Apartments, which were later constructed by Bryan. LRK registered its architectural designs for Island Park Apartments with the United States Copyright Office as an Architectural Work and Technical Drawing. *Id.* at *1. LRK also had entered into a contract with Bryan, which prohibited Bryan from infringing LRK's copyright in the design. Specifically the 1996 Agreement stated in pertinent part as follows:

> The Architectural Works, Drawings, Specifications, Technical Drawings and other documents prepared by the Architect for this Project are instruments of the Architect's service for use solely with respect to this Project and, unless otherwise provided, the Architect shall be deemed the author of these documents and shall retain all common law, statutory, and other reserved rights, including the copyright.... The Architect's Architectural Works, Drawings, Specifications, Technical Drawings or other documents shall not be used by the Owner or others on other projects, for additions to this Project or for completion of this Project by others, unless the Architect is adjudged to be in default under this Agreement, except by agreement in writing and with appropriate compensation to the Architect.

Id. (emphasis in original).

In 2001, Cypress Lake Development, a company associated with Bryan, applied for and obtained permits to construct a residential facility known as the Cypress Lake Apartments. According to LRK in the underlying action, the design of Cypress Lake Apartments infringed LRK's Island Park Apartments copyright. LRK further alleged that Bryan wrongfully used depictions of its copyrighted work in promotional and advertising materials in the operation of the Cypress Lake Apartments. *Id.* at *2.

The LRK allegations implicated certain insurance policies. The first, issued by Lafayette Insurance Company for June 28, 2000—June 28, 2001, provided coverage for "personal and advertising injury," which was defined in part as injury arising out of "g. Infringing upon another's copyright, trade dress or slogan in your 'advertisement'." *Id.* The Lafayette Policy, however, provided that the insurance did not apply to personal and advertising injury "[a]rising out of a breach of contract, except an implied contract to use another's advertising idea in your 'advertisement[ ]'....". *Id.*

State Farm also insured Bryan under a set of policies for the period of June 28, 2002—June 28, 2005. Each policy provided coverage for "personal and advertising injury," which as defined in part as injury arising out of "d. infringement of copyright, title or slogan ....". *Id.* Each State Farm policy also excluded coverage for personal and advertising injury "arising out of: a. breach of contract other than misappropriation of advertising ideas under an implied contract ....". *Id.*

State Farm intervened in the underlying action while Lafayette commenced a separate declaratory judgment action. Both actions were consolidated, and LRK and the insurers cross-moved for summary judgment. The trial court held that coverage in both policies was precluded by the policies' "breach of contract" exclusions. *Id.* at *2. However, and oddly, the trial court also held that both insurers nevertheless had a duty to defend Bryan. LRK appealed the district court's determination that the "breach of contract" exclusions precluded coverage, while the insurers appealed the trial court's determination that they had a duty to defend. The Fifth Circuit reversed the trial court's holding that the exclusions applied. *Id.*

The crux of the case, according to the Fifth Circuit, was whether a "breach of contract" exclusion applies to preclude liability for a statutory tort that an insured had a contractual obligation not to commit.

Addressing this issue, the Fifth Circuit explored two tests to determine whether the exclusion applied in the case before it. The first test was the "but for" test, in which "the injury is only considered to have arisen out of the contractual breach if the injury would not have occurred but for the breach of contract." *Id.* at *4. The second test, called the "incidental relationship" test, applies the exclusion to preclude coverage "as long as the contract bears some relationship to the dispute." *Id.*

Determining that Louisiana courts would apply the "but for" test, the Fifth Circuit held that the "breach of contract" exclusion did not apply because the liability for the alleged copyright infringement emanated from a source other than the contract, and not "but for" the contract:

> These cases establish that the Louisiana courts will not apply the "breach of contract" exclusion to preclude an insurer's liability for a tort action, even though the same factual basis could support a claim for breach of contract. The reasoning of these cases makes clear that a claim for relief cannot be considered to have "arisen out of" a breach of contract where the legal support for the claim emanates from a source other than contract law….
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> As LRK's claim for relief under the federal copyright laws would exist even in the absence of its 1996 Agreement with Bryan, the "breach of contract" provisions of the relevant insurance policies do not apply to preclude coverage for LRK's claim.

Id. at *4-5.

To bolster its reasoning, the Fifth Circuit also relied upon the principle that "ambiguous policy exclusions are to be construed against the insurer."

> Accordingly, if there is a reasonable construction that would permit coverage, that construction should be applied. The insurance policies at issue in this case do not define the "arising out of" language. Both the "but for" approach and the "incidental relationship" approach are reasonable constructions of the "breach of contract" exclusions. Thus, under Louisiana law, the construction most generous to coverage, the "but for" approach, should prevail.

Id. at *5. That the Fifth Circuit did not identify a single Louisiana decision holding that the phrase "arising out of" is ambiguous seemed to be of little importance.

That the Court made such a conclusion is further perplexing, given that in a subsequent footnote, the Fifth Court went on to conclude that even if it did employ the "incidental relationship" test, the exclusions still would not apply. *Id.* at *5, n.4.

> LRK has brought an action against the Bryan defendants for copyright infringement, not breach of contract. Here, breach of contract is only implicated because the contract was in fact breached by the infringement.

Id.

Because the Court ruled that the exclusions did not preclude coverage, the Court affirmed the trial court's determination that both insurers had a duty to defend:

> Accordingly, because, as expressed above, we conclude that LRK's copyright infringement claim is covered by the insurance policies at issue in this case, the district court's determination that the insurers have a duty to defend in this lawsuit must be affirmed.

Id.

Some may argue that *Looney* makes sense. After all, liability for the copyright infringement existed under the United States Copyright Act whether or not the contract between LRK and Bryan came into play. That is true. However, the argument fails to consider the effect of the commercial contract on the risk and an insurer's right to exclude such a risk.

By entering into a commercial contract, the parties' relationship changed the nature of the risk of infringement. Because of the relationship, Bryan became familiar with LRK's work. It may have grown to appreciate it in a way that a casual observation would not allow. And, if Bryan had not contracted with LRK, would Bryan have had the familiarity with (and a copy of) the architectural designs it was accused of infringing? Likely not. The relationship created by the contract effected the risk, which is what insurance is all about.

If an insurance company wants to exclude liability it might normally cover because such liability is related to a contract, it should have the right to do so. *Looney* didn't get that.

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