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LIABILITY INSURANCE COVERAGE FOR COPYRIGHT INFRINGEMENT: A COPYRIGHT PRACTITIONER'S GUIDE

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INTRODUCTION

Fortuity is a fundamental principle underlying liability insurance.[2] For this reason, intentional acts, as well as liabilities arising from an insured's contractual commitments, are generally excluded from coverage.

At the same time, copyright infringement is one of the covered "offenses" which is enumerated in the "advertising injury" portion of a typical Commercial General Liability ("CGL") policy. In many cases, a claim for copyright infringement arises when a licensee is alleged to have breached the terms of the license agreement under which the licensee was given the right (often limited by duration, type of media and other limitations) to exploit the underlying work. In such circumstances, the copyright licensee will seek to obtain coverage from its insurer.[3]

The cases involving coverage disputes illustrate an important intersection between copyright and insurance law. This article analyzes the pertinent cases in this area, provides an analytical framework for evaluating coverage problems and suggests tools that policyholders can use to obtain coverage in difficult cases.

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2 "[F]ortuity is an inherent requirement of all risk insurance policies. . . . 'The concept of insurance is that the parties, in effect, wager against the occurrence or non-occurrence of a specified event; the carrier insures against a risk, not a certainty.'" Two Pesos v. Gulf Ins. Co., 901 S.W.2d 495, 501 (Tex. Ct. App. 1995) (citation omitted).

3 It should be emphasized that in order to be covered under the "advertising injury" portion of a CGL policy, the infringement must occur either "in" the policyholder's advertising or must have been committed "during the course of advertising." As discussed below (note 4 *infra*), the current trend is that "in the course of advertising language" is used by carriers to limit the scope of coverage to those circumstances where the alleged infringement occurs during a wide-scale advertising campaign, as opposed to more limited forms of advertising. *See*, *e.g.*, Hameid v. Nat'l Fire Ins. of Hartford, 71 P.3d 761 (Cal. 2003).

I. BASIC GRANT OF LIABILITY INSURANCE COVERAGE FOR COPYRIGHT INFRINGEMENT

Among the covered "offenses" typically included within Coverage B is the "infring[ement] [of] another's copyright, trade dress or slogan in your 'advertisement.'" Thus, on its face, the licensee's CGL policy will typically provide coverage for copyright infringement.[4] At the same time, such policies also typically exclude coverage for certain personal and advertising injuries arising out of breach of contract. A current version of this exclusion reads as follows:

> [This insurance does not apply to] [p]ersonal and advertising injury arising out of a breach of contract, except an implied contract to use another's advertising idea in your "advertisement."

This exclusion takes on particular importance in those copyright disputes that arise in the context of an alleged breach of a license agreement. In these disputes, a licensee is alleged to have breached the underlying license by, for example, using the copyrighted material beyond the time period provided for in the license or in a manner not authorized by the license. As more fully discussed below, the first step in analyzing coverage for these kinds of disputes is to classify the nature of the dispute.

II. CLASSIFICATION OF THE CLAIM IS KEY TO DETERMINING COVERAGE

In cases involving the breach of a copyright license, a carrier may claim that the underlying suit does not assert a claim for copyright infringement, as opposed to a claim for breach of contract. Thus, for example, where the gravamen of the underlying suit is that the defendant-insured exceeded the scope of the copyright license, the carrier may seek to avoid coverage by characterizing the underlying claim as one sounding in breach of contract, as opposed to copyright infringement.

4 Prior to the advent of the 1998 and 2001 ISO forms, a key dispute that arose in this area was whether the insured could show the required nexus between the infringement and its advertising. *See*, *e.g.*, Sentry Ins. v. R.J. Weber Co., 2 F.3d 554 (5th Cir. 1993) (publishing, distributing, and selling opponent's copyrighted works does not bear sufficient casual connection to sustain coverage for advertising injury); Robert Bowden, Inc. v. Aetna Cas. & Sur. Co., 977 F. Supp. 1475 (N.D. Ga. 1997) (no nexus found when insured claimed it was induced to copy software in order to create its advertising campaign). *See also Hameid*, 71 P.3d 761 (construing "in the course of advertising" language under the earlier ISO forms to mean wide-spread dissemination of advertising, as opposed to one-on-one solicitation). Under the new ISO forms, copyright infringement must now occur "in" the policyholder's "advertisement."

Whether a particular claim is deemed to constitute the "offense" of copyright infringement for purposes of coverage under a CGL policy will likely depend on whether the claim "arises under the Copyright Act" for purposes of establishing federal subject matter jurisdiction. In this regard, practitioners seeking to obtain insurance coverage in respect to copyright infringement claims will need to address the federal jurisprudence concerning whether a claim under the Copyright Act has been asserted. In this regard, the most commonly cited test for whether federal jurisdiction exists for a particular claim (under the Copyright Act) is in *T.B. Harms Co. v. Eliscu*:[5]

> Mindful of the hazards of formulation in this treacherous area, we think that an action "arises under" the Copyright Act if and only if the complaint is for a remedy expressly granted by the Act, e.g., a suit for infringement or for the statutory royalties for record reproduction, 17 U.S.C. § 101 [citation omitted] or asserts a claim requiring construction of the Act . . . or, at the very least and perhaps more doubtfully, presents a case where a distinctive policy of the Act requires that federal principles control the disposition of the claim. The general interest that copyrights, like all other forms of property, should be enjoyed by their true owner is not enough to meet this last test.[6]

Put simply, "[w]hen a complaint alleges a claim or seeks a remedy provided by the Copyright Act, federal jurisdiction is properly invoked."[7]

Importantly, there is ample case law which supports the principle that *a claim against a copyright licensee for breach of the copyright license* may "arise under the Copyright Act" for purposes of establishing subject matter jurisdiction in federal court.[8] These cases have implications for insurance coverage: to the extent that a claim for breach of a copyright license agreement states a claim "arising under the Copyright Act," the insured-licensee will more likely be able to establish the underlying copyright infringement "offense" for purposes of obtaining coverage.

In *Kamakazi Music Corp. v. Robbins Music Corp.*, Kamakazi Music ("Kamakazi") licensed defendant Robbins Music ("Robbins") until the end of 1979 to print and sell the sheet music of pop star Barry Manilow.

5 339 F.2d 823 (2d Cir. 1964), *cert. denied*, 381 U.S. 915 (1965).

6 *Id.* at 828.

7 Basset v. Mashantucket Pequot Tribe, 204 F.3d 343, 355 (2d Cir. 2000).

8 *See* Kamakazi Music Corp. v. Robbins Music Corp., 684 F.2d 228, 230 (2d Cir. 1982) ("Kamakazi's suit is, was, and always has been based on the Copyright Act. Kamakazi sued Robbins for publishing Manilow works after the contract between the two had expired. Once the contract had expired, Robbins was liable for infringement of Kamakaze's copyrights."); Gerig v. Krause Publ'ns, Inc., 58 F. Supp. 2d 1261, 1268 (D. Kan. 1999).

After the end of 1979, however, Robbins continued to sell the sheet music, contending it could do so based on its interpretation of a provision in the license agreement relating to Robbins' right after 1979 to sell "mixed folios" of the sheet music. Kamakazi filed suit under the Copyright Act. Following the district court's confirmation of an arbitration award in favor of Kamakazi, Robbins appealed, claiming, among other things, that the district court had lacked subject matter jurisdiction. Robbins claimed that because its liability turned on a question of contact interpretation, no claim was asserted under the Copyright Act. The Second Circuit rejected Robbins' contention that no Copyright Act claim was presented:

> We agree with Judge Sweet that the district court had jurisdiction. Kamakazi's suit is, was, and always has been based on the Copyright Act. Kamakazi sued Robbins for publishing Manilow works after the contract between the two had expired. Once the contract had expired, Robbins was liable for infringement of Kamakazi's copyrights. Given the explicit language of Kamakazi's complaint, and the acts complained of, it is frivolous for Robbins to contend that its contractual defense makes Kamakazi's suit one for breach of contract. The district court had jurisdiction because the claim was for copyright infringement. The claim sent to the arbitrator was for copyright infringement. The damages calculated by the arbitrator at Robbins' urging were for copyright infringement.[9]

The court reached a similar conclusion in *Gerig v. Krause Publications, Inc.*[10] In that case, defendant magazine hired plaintiff photographer to take photographs for its magazine. Defendant later republished some of the photographs in a book which plaintiff claimed was a breach of contract and copyright infringement. Defendant moved to dismiss the complaint for lack of subject matter jurisdiction on the ground that there was no claim asserted under the Copyright Act. The district court denied the motion on the ground that the contract claim arose under the Copyright Act because it alleged that the defendant had used the photographs beyond the scope of its license:

> Once an assignment or license has expired, "the copyright proprietor may hold his former grantee liable as an infringer for subsequent use of the work."[11] This proposition has found support among other courts and commentators. *See e.g.*, *Kamakazi Music Corp. v. Robbins Music Corp.*, 684 F.2d 228, 230 (2d Cir. 1982) (finding claim arose under the Copyright Act; "Kamakazi sued Robbins for publishing Manilow works after the contract between the two had expired. Once the contract had expired, Robbins was liable for infringement of Kamakazi's copyrights."); *Demalco Ltd. v. Feltner*, 588 F.Supp. 1277, 1280 (S.D.N.Y. 1984) ("Because the contract between Rapaport and plaintiff expired by its own terms, Rapaport's attempt to exploit the film after its expiration was, if anything, an infringement of plaintiff's license, not a breach of contract."); *Berger v. Computer Information Publ'g, Inc.*, 1984 WL 595, at *2 (S.D.N.Y. July 2, 1984) ("An action for copyright infringement lies once a licensing contract expires."); 3 Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 12.01[A][1][a], at 12–6 (1998). ("[A]lthough contract determinations nominally belong in state court, notwithstanding the existence of a contractual relationship between the parties, if the defendant's conduct is alleged to be without authority under such contract and further to constitute an act of statutory copyright infringement, then federal jurisdiction will be invoked.") (footnotes omitted).
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> The Court finds that Gerig's copyright claim "arises under" the Copyright Act. . . . [T]he Court is not presented with the question of whether or not the acts of Krause were sufficient to constitute a termination of the agreement. Rather, this case is one in which Krause is alleged to have published the images beyond the scope contemplated in the agreement. Further use of the images beyond their publication in the magazine required Gerig's consent. Therefore, because the alleged contract had expired, the court finds Gerig has a potential claim for copyright infringement, which rightfully belongs to this court."[12]

The importance, for purposes of assessing coverage, of determining whether a copyright claim "arises under" the Copyright Act is illustrated

[9] 684 F.2d at 230.

[10] 58 F. Supp. 2d 1261 (D. Kan. 1999).

[11] Encyclopedia Brown Prods., Ltd. v. Home Box Office, Inc., No. 91 Civ. 4092 (PKL), 1994 U.S. Dist. LEXIS 21372, at *21 (S.D.N.Y. Aug. 24, 1994).

[12] 58 F. Supp. 2d at 1268. Not every action predicated on rights derived from the Copyright Act, however, is necessarily one "arising under" the Copyright Act. *See* Yount v. Acuff Rose-Opryland, 103 F.3d 830, 834 (9th Cir. 1996) (construction of an assignment of royalties under copyright implicates strictly a question of state law); Dolch v. United California Bank, 702 F.2d 178 (9th Cir. 1983) (claim that assignment of copyright was invalid for lack of consideration is strictly a question of state law); Dosey v. Money Mack Music, Inc., 304 F. Supp. 2d 858, 867 (E.D. La. 2003) (in action for rescission of a contract involving copyrights, the state courts have jurisdiction); Wolfe v. United Artists Corp., 583 F. Supp. 52, 56 (E.D. Pa. 1983) (no federal jurisdiction when defendants continued to collect royalties on plaintiff's work after expiration of contractual right to do so, and failed to repay these royalties to plaintiffs).

by *Goodheart-Willcox Co. v. First National Insurance Co.*[13] In that case, the plaintiff-licensor in the underlying suit alleged that the defendant-licensee had violated the terms of a license by sub-licensing certain software. The plaintiff-licensor sued for breach of contract and for copyright infringement in federal court. The defendant-licensee tendered the case to its CGL carrier.

While the coverage suit was pending, the defendant-licensee successfully moved to dismiss the copyright claims in the underlying suit. The defendant-licensee successfully argued that the copyright claims were "subsumed" within the plaintiff-licensor's breach of contract claims and hence no claim "arising under" the Copyright Act was stated.

This victory for the defendant-licensee in the underlying suit, however, was short-lived because it brought immediate defeat in the coverage suit. Since the defendant-licensee was now only facing a breach of contract claim from its former licensor, the court in the coverage suit determined that the "breach of contract" exclusion in the licensee's CGL policy precluded coverage for the suit.[14]

The lesson of *Kamakazi Music*, *Gerig* and *Goodheart-Wilcox* is that the first task for the practitioner is to classify the nature of the particular suit. As demonstrated below, that classification will ultimately determine the nature and extent of available insurance coverage.

A. Cases Involving "Pure" Infringement

The copyright infringement claims most likely to be covered are those where there is no license agreement or other pre-existing contractual relationship between the parties. In this category of claims, the defendant is alleged to have simply utilized the plaintiff's copyrighted work without authorization.

Because such a "pure" infringement claim arises in the absence of any license or other agreement between the parties, coverage is more likely because the underlying infringement "offense" can be more readily established and the breach of contract exclusion will not apply. *Interface, Inc. v. The Standard Fire Insurance Co*.[15] is an example of such a "pure" infringement claim. In *Interface*, the court had to address the question of coverage for a copyright infringement suit. In resisting a determination of coverage, the insurer argued that the breach of contract exclusion barred coverage. Finding that there was no pre-existing contractual relationship between

13 No. 00 C 0411, 2001 U.S. Dist. LEXIS 6284 (N.D. Ill. May 8, 2001).
14 *Id*. at *26.
15 No. 1:99-cv-1485-MHS, 2000 U.S. Dist. LEXIS 14019 (N.D. Ga. Aug. 10, 2000).

the plaintiff and the defendant in the infringement suit, the court rejected the insurer's contention and granted summary judgment to the insured.

B. Cases Involving "Mixed" Actions

In some cases, a party will be faced with a "mixed" action, in which "pure" claims for infringement are joined with claims for breach of a license agreement. For example, a plaintiff might join claims for breach of a license agreement (as to some works) with claims for "pure" infringement (as to other works). In this kind of scenario, the carrier's separate obligations to defend and indemnify will have to be separately analyzed.

1. Duty to Defend.

In many jurisdictions, the law requires that where an insured is facing a "mixed" action (involving covered and non covered claims), insurers cannot "parse" their coverage obligations, but must instead defend the entire action.[16] Thus, in *Platinum Technology, Inc. v. Federal Insurance Co*.,[17] the insured allegedly breached a contract with the trademark owner by using the trademark in ways not authorized by the agreement. In addition to asserting claims for breach of the trademark license, the trademark owner also asserted trademark infringement claims which were unrelated to the breach of contract claim. Because in these circumstances the application of the "breach of contract" exclusion was not free from doubt, the court declared that the insurance company had a duty to defend its insured in the underlying action.

2. Duty to Indemnify.

An insurer's duty to indemnify an insured facing a "mixed action" is not as broad as its duty to defend. Thus, if the underlying dispute results in a judgment against the insured, and assuming that the carrier has not breached its duty to defend, courts will sometimes reduce the amount reimbursable by the insurer, if "some of the damages awarded in the underlying action against the insured were not within the coverage of the policy."[18]

In such instances, the burden of proof on the allocation of covered and non-covered claims will fall on the carrier. Thus, in *Peterson Tractor Co. v. Travelers Indemnity Co.*,[19] the Ninth Circuit held that the district court erred when it "placed the burden of proof on [the insured], and not

16 *See*, *e.g.*, Buss v. Super. Ct., 65 Cal. Rptr. 2d 366 (Ct. App. 1997).
17 No. 99 C 7378, 2000 WL 875881 (N.D. Ill. June 28, 2000), *rev'd on other grounds*, 282 F.3d 927 (7th Cir. 2002).
18 Hogan v. Midland Nat'l Ins. Co., 476 P.2d 825, 832 (Cal. 1970).
19 156 F. App'x 21 (9th Cir. 2005).

[the insurer], to allocate [a] settlement . . . between covered and uncovered claims."[20] In that case, the claimant in the underlying lawsuit had alleged that the insured had, without authorization, used trademarks for which the claimant "had an exclusive license in the western hemisphere . . . . This claim stated an advertising injury [triggering insurer's duty to defend], either as a misappropriation of . . . advertising ideas . . . or as an infringement of title."[21] The lawsuit was ultimately settled. Applying *Hogan*'s reasoning regarding allocation of judgments in the context of a settlement, the Ninth Circuit held that:

> [T]he burden rests on the insured initially to show that at least a portion of the settlement involved compensation for damages attributable to claims that were covered by the insurance policy. Once the insured has satisfied that burden, the burden of proof shifts to the insurer to show what portion of the settlement is attributable to covered claims. Because the district court placed the burden of allocation on the insured, rather than the insurer, we must reverse its judgment in part, and remand for a re-allocation of the settlement.[22]

On remand, the district court found that 1) the insured had "satisfied its burden of showing that a portion of the amount [the insured] paid to [the claimant] in the settlement involved compensation for damages attributable to claims that were covered by the policy";[23] and 2) that insurer "offered no evidence that would allow this court to allocate the settlement amount between covered and uncovered claims."[24] Thus, the insured was entitled to indemnity for the entire amount of the settlement.[25]

A carrier's entitlement to post-judgment or post-settlement allocation may be significantly affected by whether that carrier has fully discharged its duty to defend. Thus, there is case law to support the proposition that a carrier that breaches its duty to defend, and who thereafter seeks to allocate any indemnity payment as between covered and non-covered claims,

20 *Id.* at 23.

21 *Id.*

22 *Id.* at 24.

23 Peterson Tractor Co. v. Travelers Indem. Co. of Illinois, No. C 01-3503 SBA (JL), 2006 U.S. Dist. LEXIS 20050, at *7 (N.D. Cal. Apr. 5, 2006).

24 *Id.* at *8.

25 *Id.*

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will have to meet a "very heavy burden of proof" on this issue.[26] Other courts have been more forgiving.[27]

C. *Cases Involving the Breach Of a Copyright License*

The third category of cases are those involving an infringement claim based on the breach of a pre-existing license agreement. Assuming (as in *Kamakazi Music* and *Gerig*) that the underlying case nevertheless is found to "arise under" the Copyright Act, the key dispute will involve the application of the "breach of contract" exclusion.

In cases involving claims of these kinds, courts have taken two diametrically opposed approaches in construing the breach of contract exclusion. Some courts have construed the exclusion broadly to include injury "arising out of," "having its origins in," "growing out of" or "flowing from" the contractual relationship.[28] Other courts have employed a "but for" test whereby 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.[29] As demonstrated below, the outcomes of these two tests are at the polar extremes: identical fact patterns will yield opposite coverage outcomes depending on which of these two tests is applied. These divergent results emphasize that the choice of applicable law can sometimes determine the outcome of coverage disputes.

26 *See*, *e.g.*, Foxfire, Inc. v. New Hampshire Ins. Co., Nos. C-91-2940 MHP ARB, C-91-3464 MHP, 1994 U.S. Dist. LEXIS 9249, at *5 (N.D. Cal. July 1, 1994); Sentex Sys., Inc. v. Hartford Accident & Indem. Co., 882 F. Supp. 930, 946 (C.D. Cal. 1995). According to one court, an insurer who has wrongfully refused to defend its insured must reimburse the insured for "all sums reasonably paid to [the injured party] . . . pursuant to a judgment . . . or a reasonable settlement negotiated by [insured]." Rankin v. Curtis, 228 Cal. Rptr. 753, 758 (Ct. App. 1986). Thus, if the dispute is settled, "the insured is given the benefit of an evidentiary presumption. In a later action against the insurer for reimbursement based on a breach of its contractual duty to defend the action, a reasonable settlement made by the insured to terminate the underlying claim against him may be used as presumptive evidence of the insured's liability on the underlying claim, and the amount of such liability." Isaacson v. California Ins. Guar. Ass'n, 750 P.2d 297, 308 (Cal. 1988).

27 *See*, *e.g.*, Zurich Ins. Co. v. Killer Music, 998 F.2d 674, 679-80 (9th Cir. 1993) (carrier that breached duty to defend is nevertheless allowed to allocate indemnity payment as between covered and noncovered claims).

28 *See*, *e.g.*, Callas Enters., Inc. v. Travelers Indem. Co., 193 F.3d 952, 955-56 (8th Cir. 1999).

29 *See*, *e.g.*, Hugo Boss Fashions, Inc. v. Fed. Ins. Co., 252 F.3d 608, 623 n.15 (2d Cir. 2001).

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1. *The "Arising Out of" Test*

As noted above, the typical "breach of contract" exclusion in a CGL policy bars coverage for claims "arising out of a breach of contract." Those courts which apply the "arising out of" test have held that this language bars coverage for claims "originating from," "having their origins in," "growing out of," of "flowing from" a breach of contract. Put simply, these courts would disallow coverage where the gist of the infringement action springs from the licensee's breach of the license agreement.

Illustrative of these cases is *Sport Supply Group, Inc. v. Columbia Casualty Company*.[30] Citing *Callas*, the Court of Appeals for the Fifth Circuit denied coverage to an insured, holding that under Texas law, "when an exclusion prevents coverage for injuries 'arising out of' particular conduct, '[a] claim need only bear an *incidental relationship* to the described conduct for the exclusion to apply.' "[31]

The underlying dispute involved a licensing agreement between MacMark and the insured, which permitted the insured to use MacMark's trademark on certain sporting goods.[32] MacMark "later accused the insured of breaching that licensing agreement by attempting to sell products bearing [the trademark] on the Internet."[33] MacMark then sent a letter to the insured, declaring that the licensing agreement was terminated.[34] The insured filed "an action in Texas state court seeking a declaration that it was not in breach of the agreement."[35] MacMark responded by filing a counterclaim, alleging breach of the licensing agreement.[36] The portion of the policy at issue contained an exclusion for " 'advertising injury' *arising out of* . . . breach of contract, other than misappropriation of advertising ideas under an implied contract."[37]

The court construed the "breach of contract" exclusion under the "arising out of" test, holding that because MacMark's counterclaim alleged that insured breached the licensing agreement by advertising and selling products with the trademark on the Internet, "[i]t seems clear that MacMark's alleged injury bears at least an 'incidental relationship' with [the insured's] breach of contract."[38] The court held that the exclusion applied and that insurer had no duty to defend.[39]

[30] 335 F.3d 453 (5th Cir. 2003).
[31] *Id.* at 458 (emphasis in original).
[32] *Id.* at 456.
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.* at 458 (emphasis in original).
[38] *Id.*
[39] *Id.* at 465.

Other courts which have adopted the "arising out of" approach include *Callas Enterprises, Inc. v. Travelers Insurance Co.*,[40] *Southstar Corp. v. St. Paul Surplus Lines Co.*,[41] *Fallon McElligott, Inc. v. Seabord Surety Co.*.[42]

2. *The "But For" Test*

By contrast, a number of jurisdictions have adopted the more coverage-friendly "but for" test for the application of the "breach of contract" exclusion. Pursuant to that test, the court's inquiry will be whether the plaintiff in the underlying liability case would not have sustained injury "but for" the breach by the insured-defendant of the contract between those parties. Put simply, under this test the "breach of contract" exclusion will only apply if the insured-defendant's breach is the sole cause of the liability plaintiff's injuries.

Illustrative of this approach is the *Hugo Boss* case.[43] In that case, the court held that a "breach of contract" exclusion did not excuse insurer's duty to defend when the licensor's rights to the underlying intellectual property existed independently of any licensing agreement with the insured.

In the underlying action, Hugo Boss and the Boss Manufacturing Company ("BMC") had entered into a "Concurrent Use Agreement . . . [pursuant to which Hugo Boss agreed not to] 'sell or license others to sell gloves, mittens or boots with a mark that incorporates the word "Boss."' "[44] The parties also agreed to "cross-license their marks for certain products at designated price points . . . representing separate consumer markets."[45] The purpose of the agreement was to "establish guidelines that would prevent consumer confusion and would keep the parties from infringing each others' trademark rights."[46] When BMC learned that Hugo Boss had violated the agreements by selling gloves and boots with the term "Boss" on them, BMC filed suit for trademark infringement.[47]

Prior to settling the liability suit, Hugo Boss sued its carrier, Federal Insurance Company ("Federal"), for failing to defend.[48] The trial court,

[40] 193 F.3d 952 (8th Cir. 1999).
[41] Nos. C-91-2940 MHP ARB, C-91-3464 MHP, 2001 Tex. App. LEXIS 1078 (Ct. App. Feb. 15, 2001).
[42] 607 N.W.2d 801 (Minn. Ct. App. 2000).
[43] Hugo Boss Fashions, Inc. v. Fed. Ins. Co., 252 F.3d 608 (2d Cir. 2001).
[44] *Id.* at 611.
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] *Id.* at 613.

applying the "but for" test, rejected Federal's claim that coverage was barred based on the "breach of contract" exclusion.[49] The Second Circuit affirmed this result:

> First, Federal contends that the "breach of contract" exclusion, which disclaims coverage for "advertising injury arising out of breach of contract," defeats plaintiffs' claim. But, as the district court properly found, this argument is foreclosed by the decision of the New York Court of Appeals in *Mount Vernon Fire Ins. Co. v. Creative Housing Ltd*., 88 N.Y.2d 347, 668 N.E.2d 404, 645 N.Y.S.2d 433 (1996). In that case the Court of Appeals held that the "but for" test governs exclusion clauses such as the breach of contract exclusion at issue here. Thus, only if the advertising injury suffered by BMC would not exist *but for* the breach of contract, would the injury "arise out of" a breach of contract. And, only then would Federal not be obligated to indemnify HB USA. As the district court explained, however, "BMC's claims against Hugo Boss . . . exist independent of the contract. . . . BMC's trademark rights arose long before it entered into the 1990 agreement with Hugo Boss [Germany] and would exist even if BMC had never entered into that agreement and/or if that agreement had not been breached."[50]

The court concluded that "sufficient uncertainty as to the applicability of the breach of contract exclusion existed so that it could not serve to eliminate [insurer's] duty to defend."[51] Similarly, in *Zurich Insurance Co. v. Killer Music*, the court held that the policy's "breach of contract" exclusion did not apply in connection with an underlying copyright infringement suit. The court found that the plaintiff's copyright claim, which alleged that the defendant had breached a license agreement by selling the licensed songs without compensating the plaintiff, could have been a claim sounding in tort, creating at least the potential for liability. Accordingly, because the exclusion did not apply, the insurance company had a duty to defend, and the trial court's decision to the contrary would be reversed.

Several other courts have also adopted the "but for" approach.[52]

49 *Id.* at 623 n.15.

50 *Id.* (emphasis in original).

51 *Id.*

52 Assurance Co. of Am. v. J.P. Structures, Nos. 95-2384, 96-1010/96-1027, 1997 U.S. App. LEXIS 34565 (6th Cir. Dec. 3, 1997); Auto Owners Ins. Co. v. LA Oasis, Inc., No. 2:04 cv 174, 2005 U.S. Dist. LEXIS 43565 (N.D. Ind. May 26, 2005); Houbigant v. Fed. Ins. Co., 374 F.3d 192 (3d Cir. 2004).

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III. TOOLS THAT POLICYHOLDERS CAN USE IN DIFFICULT CASES

Where policyholders are involved in coverage disputes in jurisdictions which have not adopted either the "arising out" or the "but for" tests, there are several arguments for coverage which should be explored.

At the threshold, it is basic that coverage grants are broadly construed while exclusions are to be narrowly construed.[53] In this regard, it is the carrier's burden to prove the applicability of an exclusion.[54] Thus, where a carrier seeks to deny coverage based on the "breach of contract" exclusion, the carrier will face a heavy burden, especially where the exclusion at issue is potentially susceptible to a meaning which would not negative the potential of coverage.[55] Since a policyholder only needs to prove a "potential for coverage" in order to trigger the duty to defend,[56] carriers will face an especially heavy burden where the exclusion at issue is unclear or has not been fully interpreted by the courts of the relevant jurisdiction.

In addition, the existence of coverage is not determined by the form of the claim asserted by the underlying claimant. Thus, in *Vandenberg v. Superior Court*,[57] the California Supreme Court held that coverage would be available for a claim involving pollution of real property was brought in the form of a breach-of-lease action. In affirming the court of appeal's determination that coverage for property damage is not necessarily precluded because they are pled as contractual damages, the California Supreme Court held that "[c]overage under a CGL insurance policy is not based on upon the fortuity of the form of action chosen by the injured party."[58] The court noted that this conclusion is buttressed by the notion that coverage is not affected by the form of the legal proceeding chosen by the plaintiff. According to one commentator cited by the court, "'[t]he expression 'legally obligated' connotes legal responsibility which is *broad* in scope. It is directed at civil liability . . . [which] can arise from either unintentional (negligent) or intentional tort, under common law, statute, or contract.'"[59]

An insured may also attempt to rebut the applicability of the "breach of contract" exclusion by establishing that underlying copyright infringe-

53 *See* State Farm Mut. Auto. Ins. Co. v. Partridge, 514 P.2d 123, 128 (Cal. 1973).

54 *See* Prichard v. Liberty Mutual Ins. Co., 101 Cal. Rptr. 2d 298, 312 (Ct. App. 2000).

55 *See* Hugo Boss Fashions, Inc. v. Fed. Ins. Co., 252 F.3d 608, 623 n.15 (2d Cir. 2001).

56 Buss v. Super. Ct., 939 P.2d 766, 773 (Cal. 1997).

57 982 P.2d 229 (Cal. 1999).

58 *Id*. at 243.

59 *Id.* at 246 (citing Donald S. Malecki & Arthur L. Flitner, Commercial General Liability 6 (6th ed. 1997)).

ment "offense" has been finally determined by the court in the liability action.

For example, in *Goodheart-Willcox*, the court determined that there would be no coverage based on the breach of contract exclusion, because the court in the underlying infringement action had dismissed the plaintiff's copyright infringement claim, finding same to be "subsumed" within the plaintiff's breach of contract claim. In essence, the court gave determinative effect, for purposes of adjudicating coverage, to a finding in the liability suit that no claim "arising under the Copyright Act" had been presented.

Goodheart-Willcox leaves unanswered the question of whether a contrary finding in the liability would also be given determinative effect for purposes of adjudicating coverage. Thus, if the court in a copyright infringement case determines that a claim "arising under the Copyright Act" has in fact been presented, will such a finding bind the defendant-insured's carrier and prevent that carrier from urging application of the breach of contract exclusion? Neither *Goodheart-Willcox* nor, to our knowledge, any other reported case, addresses that question. Another approach worth considering is to examine the origins and purposes of the breach of contract exclusion. For example, at least one commentator has noted that "[a] basic purpose of the [breach of contract] exclusion is to clarify that personal and advertising injury liability coverage is not intended to cover *products liability actions based on breach of warranty*."[60] Liability claims unrelated to breach of warranty may therefore raise an issue concerning whether application of the breach of warranty exclusion is appropriate.[61]

Finally, even in those jurisdictions which have adopted an expansive reading of the phrase "arising out of," there is case law which supports the principle that the scope of phrases like "arising out of" must be determined on a policy-by-policy basis. Unless a jurisdiction has adopted an interpretation of such a phrase *in context of the same kind of insurance policy at issue in the particular coverage dispute*, the policyholder may be free to urge an interpretation of such language which is favorable to a finding of coverage:

> [T]he phrase "arising out of" has no "single 'settled meaning' that applies to every insurance policy." *Philadelphia Indem. Ins. Co. v. Maryland Yacht Club, Inc.*, 129 Md.App. 455, 742 A.2d 79, 86 (1999). The court elaborated that "we construe such phrases 'on a contract by contract or case by case basis,' and not by sweeping language saying that regardless of the exact provisions of the contract we shall interpret all similar, but not identical, contracts alike." *Id*. . . . . Accordingly, while guided by past interpretations of the "arising out of" language, this Court will also "examine the character of the contract, its purpose, and the facts and circumstances of the parties at the time of the execution." *Litz v. State Farm Fire & Cas. Co.*, 346 Md. 217, 695 A.2d 566, 569 (1997).
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> CGL policies are purchased by business owners "in an attempt to protect against losses that may result from unforeseen liability-imposing events or circumstances." *Doerr v. Mobil Oil Corp.*, 774 So.2d 119, 127 (La. 2000). They '"provide the insured with the broadest spectrum of protection for unintentional and unexpected personal injury or property damage arising out of the conduct of the insured's business."'. . . As a result, the policies do not cover the contractual liability of the insured. *The breach of contract exclusion, however, is not intended to excuse the insurer from defending any action that alleges a breach of contract*. Indeed, as Plaintiffs argue, "clever drafters could prevent an insured from obtaining coverage by merely alleging the existence of a contract."[62]

This language from *Teletronics* makes it clear that the court's construction of the phrase "arising under" may vary depending on the nature of the insurance policy at issue. Thus, even in a jurisdiction whose courts construe that phrase broadly in one context may not necessarily apply such a broad interpretation where that phrase is used in the advertising injury area.

CONCLUSION

Finding insurance coverage for copyright infringement remains challenging. As noted above,[63] the scope of the covered "offense" has been restricted in recent years as a result of the evolution of the ISO forms. In addition, any claim for copyright infringement which is based on the alleged breach of a license agreement will necessarily implicate of the "breach of contract" exclusion which is typically part of all CGL policies. Nevertheless, because courts continue to read an insurer's duty to defend in extremely broad terms, parties sued in connection with these kinds of case should tender these claims to their CGL carriers.

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[60] Donald S. Malecki & Arthur S. Flitner, Commercial General Liability 99 (7th ed. 2001) (emphasis added).

[61] *See* Fantasia Accessories, Ltd. v. Northern Assurance Co. of Am., No. 01 Civ. 663 (AGS), 2001 U.S. District LEXIS 18865 (S.D.N.Y. Nov. 19, 2001) (applying the breach of contract exclusion to bar coverage in a case involving an alleged breach of warranty).

[62] Teletronics Int'l, Inc. v. CNA Ins. Co., 302 F. Supp. 2d 442, 454 (D. Md. 2004), *rev'd on other grounds*, 120 F. App'x 440 (4th Cir. 2005) (emphasis added).

[63] *See* note 3 *supra*.