

# The Coverage Inkwell

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



Joshua A. Mooney  
mooneyj@whiteandwilliams.com

*January 26, 2013*

## **ONLY THE FAX MATTER: THE PHRASE “KNEW OR SHOULD HAVE KNOWN” DOES NOT ALLEGE NEGLIGENCE**

It’s a new year. By my rough count, I already have received about 15 junk faxes (and that does not include the salacious solicitations captured by Postini). What I find particularly irritating is that some of the “UnknownFaxMachine” messages thrown into my email server are actually legitimate correspondences, which means that I have to look at everything. And, this collection of facsimiles always includes “amazing” vacation packages, insurance deals, and rates on short-term loans that even Montel Williams couldn’t beat.

We all know that junk faxes violate the Telephone Consumer Protection Act, 47 U.S.C. § 227 (TCPA), and I am certain the blast-faxing, junk fax, slick snake oil perps know it, too. So, I always take a little extra pleasure when a court renders a decision that TCPA claims do not implicate insurance coverage. Maybe that extra pleasure is petty, but when I find myself opening adverts for PC training and corporate travel, I don’t think so.

As we know, TCPA class actions also can mean big liability and big money in terms of damages and attorneys’ fees. Insurance policies were never intended to cover the type of conduct exhibited in blast faxing. To further punctuate that point, many insurance policies now have a TCPA exclusion, which prohibits coverage for violation of the TCPA (and other named statutes), and any other similar “federal, state or local statute, regulation or ordinance.” Missing from that list, however, are common law torts. Not surprisingly, in order to try to breathe new coverage life into TCPA claims, plaintiffs’ attorneys have begun to draft their complaints in such a manner to allow them (and the insureds with whom they settle) to argue that the TCPA lawsuits actually allege property damage and common law claims of conversion caused by an “occurrence.”

Typically, these complaints will allege that the insured “knew or should have known” that the junk faxes transmitted by the insureds would use up toner and paper, thereby causing “property damage” caused by an “occurrence.” The argument is that “knew or should have known” constitutes negligence, which,

in turn, satisfies the definition for “occurrence.” Stop me if you have heard this one before (or something like it).

This is where *Nationwide Mutual Insurance Co. v. David Randall Assocs.*, No. 12-4208 (E.D. Pa. Jan. 24, 2013), comes in. In *David Randall*, the Pennsylvania federal court held that an underlying TCPA action alleging the insured “knew or should have known” that (1) it did not have authorization to send junk faxes and (2) its “misappropriation of paper, toner, and employee time was wrongful” did not allege negligence to satisfy the meaning of the term “occurrence.” Therefore, there was no coverage.

Admittedly, *David Randall* does not explore issues of privacy or cyber liability, topics that are typically covered by the *Coverage Inkwell*. But because the Court’s rejection of the phrase “knew or should have known” as a gateway for coverage has such a broad application in a myriad of contexts, I deemed the decision worth covering here.

In *David Randall*, the insured, David Randall Associates, was sued by a putative class action for violations of the TCPA and conversion based on the receipt of unsolicited facsimile transmissions advertising the insured’s business. (*Memo. and Order*, pp. 2-3.) The underlying action alleged that the insured

“approved, authorized and participated in a scheme to broadcast faxes by (a) directing a list to be purchased and assembled; (b) directing and supervising employees and third parties to send the faxes; (c) creating and approving the form of faxes to be sent; (d) determining the number and frequency of the facsimile transmissions; and (e) approving and paying third parties to send the faxes.

(*Id.*, p. 3.)

As for the TCPA claim, the underlying action alleged that the insured, in relevant part, that the Defendants “knew or should have known that (a) [City Select] and the other class members had not given express invitation or permission for Defendants or anybody else to fax advertisements about Defendants’ goods or services, (b) that [City Select] and the other class members did not have an established business relationship, and (c) that [the facsimile transmission] is an advertisement.” (*Id.* (emphasis added).) As to the conversion claim, the underlying action alleged that the insured “knew or should have known that their misappropriation of paper, toner, and employee time was wrongful and without authorization.” (*Id.* (emphasis added).)

The insured argued the underlying complaint’s use of the phrase “knew or should have known” to describe the insured’s awareness of the impropriety of the fax adverts meant that the underlying action could be read to allege negligence, thus implicating coverage under its CGL policy for “property damage” caused by an “occurrence.” (*Id.*, p. 9.) The court rejected the argument, holding that such reasoning ignores the factual allegations of the complaint that set forth that the insured had acted intentionally and knowingly:

Although superficially appealing, this argument ignores the complaint's allegations of a detailed scheme to send unsolicited fax advertisements which [the insured] directed personally. E.g., *id.* ¶ 12. Read in the context of these allegations and, again, the inherently intentional nature of the transmission of fax advertisement persuasively analyzed in *Melrose Hotel*, we cannot interpret the underlying complaint's use of "knew or should have known" to allege mere negligence.

(*Id.*, pp. 9-10 (emphasis added).)

**What does this case mean?** Too many times, an underlying plaintiff alleges detailed facts about the insured's conduct, which he or she may need to do in order to meet requisite pleading standards, but then throws in a mindless negligence count in order to suck in insurance. Other times, an underlying complaint might be dressed up with "knew or should have known" allegations like the phrase is some magical spice that transforms the insured's otherwise knowing and intentional conduct into negligence.

*David Randall* highlights that, when determining coverage, a court should focus on the alleged facts, not conclusory statements and legal theories. Simply put, legal theories do not alter the nature of the facts (or the case). Or, as better explained in a construction defect coverage action by the Southern District of Texas (and Texas is always good for colorful sayings):

[I]t is axiomatic that artful pleading cannot change the character of a lawsuit. In the vernacular, calling a duck a chicken does not make it so. . . . The purported facts that give rise to the alleged actionable conduct, not the legal theory, control in determining the duty to defend.

*Indian Harbor v. KB Lone Star, Inc.*, 2012 WL 3866858, at \*14 (S.D. Tex. Sept. 5, 2012).

Questions are welcome.

## *The Coverage Inkwell*

**Joshua A. Mooney** | Counsel  
1650 Market Street | One Liberty Place, Suite 1800 | Philadelphia, PA 19103-7395  
Direct 215.864.6345 | Fax 215.399.9613  
[mooneyj@whiteandwilliams.com](mailto:mooneyj@whiteandwilliams.com) | [whiteandwilliams.com](http://whiteandwilliams.com)  
Assistant: Dana Genovese | 215.864-6331



The views expressed above are solely those of the author and are not necessarily those of White and Williams LLP or its clients. The information contained above is not legal advice; you are advised to consult with an attorney concerning how any of the issues addressed above may apply to your own situation. If you do not wish to receive future emails of The Coverage Inkwell, please "Reply" to the email address above with the title "Unsubscribe."

If you have not subscribed to The Coverage Inkwell and wish to do so, you may send an email to [mooneyj@whiteandwilliams.com](mailto:mooneyj@whiteandwilliams.com), with the title "Subscribe." Thank you.