

Customer's Refusal to Make Payments Led to Claim

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In an unpublished decision, the U.S. Court of Appeals for the Sixth Circuit, applying Michigan law, has held that a claim by a customer of the insured was first made under an E&O policy when the customer of the insured refused to make monthly payments as required by a contract. *Postek, Inc. v. St. Paul Fire & Marine Ins. Co.*, 2004 WL 1664055 (6th Cir. July 23, 2004).

The insurer issued an E&O policy to a company that developed and installed computer systems. The policy covered losses "first made or brought" on "the date that any protected person could reasonably foresee that a claim or suit would be made or brought." The policy specified that a claim is first made or brought when a customer "[r]efused to pay all or part of your charges for those products or services."

The company contracted to provide a computer system to a customer. The contract specified a price, but did not specify a payment schedule or end date for the project. The parties later modified the contract to include a monthly payment schedule. The customer paid some of the monthly invoices, including one after inception of the E&O policy, but later refused to make additional payments, alleging insufficient progress on the project. The customer then filed suit against the company for breach of contract. The insurer denied coverage and coverage action followed.

The court held that the policy did not afford coverage because the claim was first made a year before the policy incepted. Specifically, the court found that the claim accrued when the customer first stopped paying the invoices. The court rejected the company's argument that there was no refusal to pay. Instead, the court cited evidence that both the company and the customer modified the contract to include a monthly payment schedule. Even though the customer initially made several monthly payments, it later refused to make any additional payments. The court also noted that the president of the policyholder's company believed that there was a repudiation, which put the policyholder "on notice that it could foreseeably face a claim or suit."

The court rejected the company's argument that the policy required an "unconditional repudiation of any payment obligation." Instead, the court found that the customer communicated its intent to withhold future payments until additional progress was made. The court concluded that although..."not every 'failure to pay' necessarily constitutes a 'refusal to pay'...the facts of this case go well beyond any such hypothetical."

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