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NEWSLETTER

Breach of Contract Exclusion Bars Coverage for Claims Naturally Resulting from Breach

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Applying Michigan law, the United States Court of Appeals for the Sixth Circuit has held that a breach of contract exclusion precludes coverage for retaliation claims that are the natural and foreseeable result of a breach of contract. *City of Warren, Mich. v. Int'l Ins. Co. of Hannover, Ltd.*, 2013 WL 1798989 (6th Cir. April 30, 2013).

Pursuant to a contract executed with a waste-transport contractor, a municipality was required to use "commercially acceptable best efforts" to install and make operational an additional "Direct Dump System." After the municipality failed to install a third compactor to handle yard waste, a part of the "Dump System" according to the contractor, the contractor began to withhold royalty payments from the municipality. In response, the municipality withheld payments from the contractor's monthly invoices. The contractor sued the city for, *inter alia*, breach of contract, retaliation in violation of 42 U.S.C. § 1983 and a conspiracy to retaliate, consequently procuring a settlement. After the municipality tendered the underlying claim, the insurer denied coverage, citing, among other defenses, an exclusion for errors and omissions "arising out of . . . breach of a contractual obligation."

In the coverage litigation that followed, the court held that the breach of contract exclusion unambiguously precluded coverage for the underlying claim and rejected the insurer's argument that the exclusion did not apply to the Section 1983 and conspiracy-to-retaliate claims since they allegedly did not "arise out of" a breach of contract. The court held that an injury must be "foreseeable" rather than merely "incidental, fortuitous or but for" in order to "arise out of" its supposed cause. According to the court, the dispute over royalty payments was a "natural and foreseeable result" of the municipality's breach of contract. Hence, the court found that the retaliation claims arose out of this breach of contract.