THE ONGOING ARGUMENT OF ONGOING OPERATIONS

COURTS MUST PROVIDE CLARITY IN ADDITIONAL INSURED COVERAGE DISPUTES

BY MICHAEL PARME

While the insurance industry intended the concept of ongoing operations to be a limit on the scope of additional insured coverage, judicial approach and interpretations have evolved in recent years. As a result, courts have adopted an analytical approach that has broadened the scope of an insurer's obligation to additional insureds.

Even where there is strong evidence that new or revised language specifically excludes damage occurring after the named insured's operations are completed, the trend is toward concluding that additional insured coverage may exist.

What Is an Ongoing Operation?

Nearly all construction contracts require a subcontractor to name the developer or general contractor as an additional insured on its general liability policy. Commonly, these additional insured endorsements contain language providing that additional insured coverage extends to liability for "bodily injury" or "property damage" that is "caused, in whole or in part, by…acts or omissions" of the subcontractor "in the performance of [the subcontractor's] ongoing operations for the additional insured(s)…."

This is the language employed by the most common Insurance Services Office (ISO) additional insured endorsement forms. It should be noted that some insurers have adopted variations of this language.

Approaching interpretation solely from the standpoint of the plain meaning of the words, it is fair to define "ongoing operations" as "work in progress." In other words, when the contractor is finished working on the job, the additional insured coverage also terminates with no lingering exposure presented with respect to future liability or damage that has yet to occur.

Conceptually, this means that the additional insured obligation covers the risk of property damage and/or bodily injury presented by the contractor's presence on the job site, and activity in furtherance of the project. But, gradually, courts have elaborated nuances regarding what an ongoing operation is. For example, it has been found that a contractor's continued responsibility for supervision after completion of work may be part of an ongoing operation. It has also been held that incomplete work may be an ongoing operation. In fact, courts have held that even work performed by a contractor deficiently or not performed in compliance with express or implied terms of a contract may be construed as an ongoing operation.

Getting to the Big Question

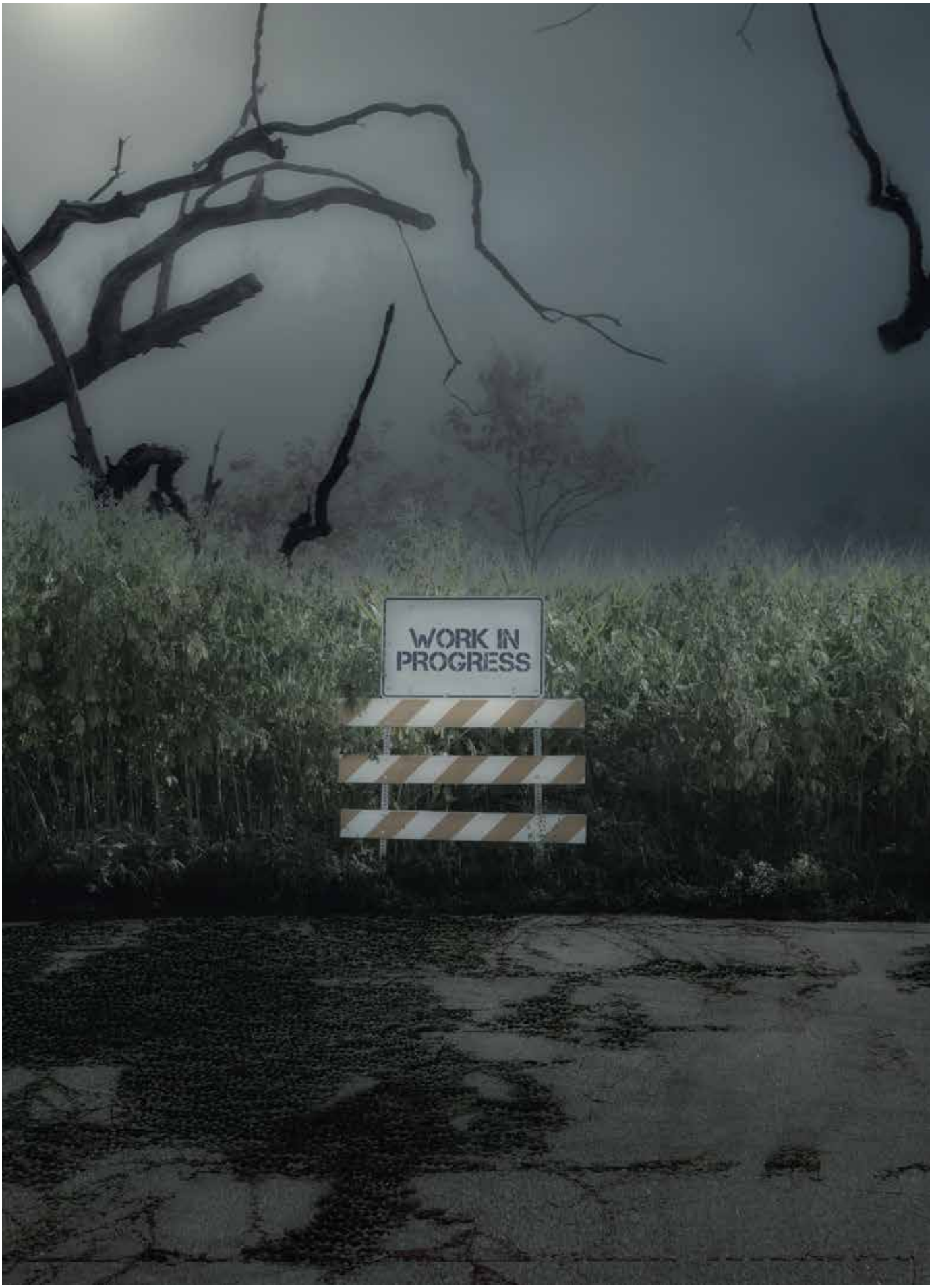
While these distinctions and embellishments are not insignificant, this is not the most significant question affecting the construction industry. As this article will show, interpreting scope of ongoing operations coverage has less to do with the term "ongoing operations" than the language around it. It is important to realize that additional insured coverage encompasses the duty of a subcontractor's insurer to defend its additional insured with respect to liabilities connected to the subcontractor's work.

It is axiomatic that the duty to defend is broader than the duty to indemnify, and extends to any claim or suit that is potentially covered. This means that the crucial question with respect to additional insured coverage is whether the allegations or evidence presented to the subcontractor's insurer is sufficient to show that property damage or bodily injury occurred during the subcontractor's ongoing operations. If there are allegations or evidence that suggest it did, the insurer is presumably obligated to provide or share in the developer's or general contractor's defense based on the potential for additional insured coverage.

Conflicting Interpretations

The evolution in how courts have approached ongoing operations highlights the ideological void between insurers and the developers and general contractors, and there is little question that this history can be seen as a chronology of disappointments for insurers.

The initial policy endorsements that incorporated the ongoing operations language were developed in order to draw a contrast between named insured and additional insured. With respect to the named insured, completed operations coverage was already afforded under the products-completed operations hazard. Under that provision, it is clear what constitutes a completed operation—namely, the policy defines it as "[w]ork that has not yet been completed or abandoned."


WORK IN
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It further specifies work is "deemed completed at the earliest of the following times: (a) When all of the work called for in your contract has been completed. (b) When all of the work to be done at the job site has been completed if your contract calls for work at more than one job site. (c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project."

The inclusion of the term ongoing operations in the ISO additional endorsement forms was intended as a means of limiting coverage to the contractor's work that had not been completed. In fact, this was recognized at least as early as 2000 in *Pardee Construction Co. v. Insurance Co. of the West 77 Cal.App.4th 1340 (2000)*. The court in that case concluded that ongoing operations language in ISO additional insured endorsements was intended to limit the scope of the additional insured obligation. Since the endorsement at issue in *Pardee* did not incorporate ongoing operations language, the court concluded that "the insurers' failure to use available language expressly excluding completed operations coverage implies a manifested intent not to do so."

The same drafting history was cited in *Weitz Co. LLC v. Mid-Century Ins. Co. 181 P.3d 309 (2007)*, where a Colorado court held that the history of the ISO forms supported "the plain and ordinary meaning" of ongoing operations language.

A Change in Interpretation

However, since as early as 2006, the trend has been largely to ignore the drafting history and industry commentary when interpreting additional insured endorsement coverage for ongoing operations. Instead, courts concluded "ongoing operations" is an ambiguous term that might cover ongoing and completed operations.

This trend is traceable to *Valley Ins. Co. v. Wellington Cheswick, LLC, No. 05–1886, 2006 WL 3030282, at *5 (W.D.Wash.2006)*, which was referenced in an unpublished Ninth Circuit decision in *Tri-Star Theme Builders, Inc. v. OneBeacon Ins. Co., 426 F. App'x 506 (9th Cir. 2011)*. These decisions shifted the analytical approach from reliance on the historical evolution of the endorsement language to evaluating the plain language. The decisions emphasized that if the insurer intended to exclude completed operations from the scope of additional insured coverage, there needed to be an express statement to this effect.

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The rationale in these cases was further explored in *Pulte Home Corp. v. American Safety Indemnity Co. 14 Cal. App.5th 1086*. *Pulte* dealt with an underlying construction defect action where the developer required in its contracts that subcontractors add it to their general liability policies through a CL 2010 10 93 additional insured endorsement (or equivalent), which specified Pulte would be covered, "but only with respect to liability arising out of your ongoing operations performed for that insured."

The American Safety endorsement at issue specified that the additional insured coverage extended to "liability arising out of 'your work,' 'but only as respects ongoing operations.'" The court held that American Safety's endorsements did not clearly restrict coverage to only ongoing operations, stating that if the insurer "wished to make it clear to Pulte that it was not covering completed operations for the additional insured…, it could have clearly said so."

While evaluating the plain meaning of policy language has always been a fundamental canon of contract construction dating back to the common law, the *Pulte* court, in eschewing the drafting history and evolution of ISO insurance forms, confirmed that it is the dominant consideration going forward. This approach enables courts to more easily conclude that the language of the endorsement is ambiguous, thereby placing the onus on insurers to be more precise about the risks they insure.

The Uncertain Fate of the Completed Operations Exclusion

Notwithstanding the *Pulte* decision, the insurance industry had incorporated a completed operations exclusion in additional insured endorsements since July 2004. It states that the insurance provided to the additional insured does not apply to bodily injury or property damage occurring after "[a]ll work…on the project (other than service, maintenance, or repairs)…at the location of the covered operations has been completed; or…[t]hat portion of 'your work' out of which the injury or damage arises has been put to its intended use…."

However, *McMillin v. Financial Pacific 17 Cal.App.5th 187 (2017)* cast a shadow over the idea that the exclusion limits additional insured obligation to only ongoing operations. In *McMillin*, the California Court of Appeal concluded that the completed operations exclusion language in an additional insured endorsement issued by Lexington Insurance was an insufficient basis for refusing to defend a developer that tendered its defense to

subcontractor insurers with respect to an underlying construction defect lawsuit. The *McMillin* court rejected Lexington's argument that the nonexistence of homeowners at the time the subcontractors ceased operations established a lack of potential for coverage.

The court specifically qualified its holding by stating, "[W]e do not decide whether an ongoing operations endorsement such as that used in this case provides coverage to the additional insured only for damages that occur prior to the completion of the named insured's subcontractors' ongoing operations." Rather, the court emphasized it was simply rejecting Lexington's argument that "liability," as the term is used in the endorsement, could not exist prior to homeowners purchasing their properties. The court quite deliberately stopped short of declaring the death of the completed operations exclusion.

While few decisions are perfectly reasoned, *McMillin* is a particularly problematic one from a construction industry perspective. First, while it could have been anticipated the decision would depart from earlier decisions—such as *Pardee*—that gave significant weight to the history of the most commonly used additional insured endorsement forms, the court surprisingly eschewed even the more recent approach employed in the *Pulte* decision, which scrutinized endorsement language for ambiguity. Though *McMillin* cites and discusses both *Pardee* and *Pulte*, the court implicitly avoids employing the analytical approach of either decision.

Second, it is noteworthy that the court focused on the specific language of Lexington's additional endorsements, which provided coverage for "liability *arising out of*" the named insured's ongoing operations. In reaching its conclusion, the court relied heavily on *Acceptance Ins. Co. v. Syufy Enterprises (1999) 69 Cal.App.4th 321* to give the "arising out of" language in the additional insured endorsement broad scope.

While case law has afforded broad scope to this language, it has not dealt with injury or damage with respect to construction defect litigation or the scope of ongoing operations additional insured coverage in this context. *Syufy* arose from a personal injury caused by a claimant who fell while working on a roof. The *McMillin* court did not in any way acknowledge that, while a personal injury occurs at a specific time, place, and manner, determination of when property damage occurs with respect to construction defect claims is, in most cases, far more mercurial.

Third, the court, intentionally or unintentionally, deemphasized the significance of the completed operations exclusion in the policy. The *McMillin* court noted in dicta that the trial court had not found Lexington had established, as a matter of law, that all of the property damage in the underlying action occurred only after completion of the subcontractors' operations. Based on this approach, however, it could be argued that unless an insurer presents undisputed evidence that all alleged property damage occurred after completion of operations, an insurer cannot rely on the completed operations exclusion. It further follows that if an insurer were to present such evidence in a motion for summary judgment, the denial of that motion would, as a practical matter, establish that the completed operations exclusion does not apply.

Finally, the *McMillin* court was presented with a question that had great importance from a construction industry perspective: whether the completed operations exclusion language limits the scope of ongoing operations coverage for an additional insured. The court sidestepped this question. By focusing on the "arising out of" language in the Lexington policies, the court essentially found a means to avoid the more important question. Most courts are loathe to rule beyond the specific dispute or arguments presented, but, in attempting to focus on the nuances of the arguments and language of the endorsement at issue, the court's reasoning clouds the future efficacy of language that excludes additional insured coverage for completed operations. In short, the breadth of the decision is contested, and *McMillin* has fueled more controversy than it has definitively settled.

Need for Clarity

At present, there is no indication that the pendulum is going to swing in the direction of the insurance industry—at least as far as California law is concerned. The more reasonable forecast would be that other jurisdictions will continue to adopt the analytical approach of *Pulte*, which rests upon a finding that the ongoing operations language in additional insured endorsements is ambiguous.

Nevertheless, from all concerned perspectives, one thing is certain: Clarity regarding the scope of ongoing operations coverage will yield more efficient resolution of disputes. Insurers are justified in feeling that the courts have repeatedly proscribed how to limit additional insured coverage and then moved the goal posts. If the law interpreting the scope of ongoing operations were clearer and more cohesive, there would be fewer disputes about additional insured obligations, which would drive more efficiency in the market and, theoretically, more building at less expense.

This clarity is only possible if future courts provide much needed guidance. The lesson of *McMillin* may be that it is of little use to any of the interested industry segments for courts to be overly circumspect when interpreting the scope of ongoing operations coverage. Courts leave the industry in darkness when they sidestep important questions.

It is unclear whether a more determined judicial approach would alter the trend that favors finding coverage in additional insured coverage disputes, but clarity would promote much needed consensus in such disputes and yield a more efficient model for handling and resolving construction claims. ■

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