HUNTON& WILLIAMS

Client Alert

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California Appellate Court Reinstates Construction Defect Claim, Recognizing Potential Coverage for "Ongoing Operations" Under Additional Insured Endorsement

Earlier this month, a California court reinstated a general contractor's construction defect coverage claim under its subcontractors' additional insured endorsements, reversing summary judgment and holding that the fact that homeowners did not own their homes at the time the subcontractors completed their "ongoing operations" did not establish that the general contractor could not have potential liability to the homeowners "arising out of" the subcontractors' ongoing operations.

In *McMillin Management Services, L.P. v. Financial Pacific Insurance Co.*, No. D069814 (Cal Ct. App. Nov. 14, 2017), McMillin Management Services was the general contractor for a residential development project in Brawley, California. Two of McMillin's subcontractors hired to work on the project obtained general liability policies naming McMillin as an additional insured. Construction of the homes was completed in 2005. Several years later, homeowners within the development filed a lawsuit against McMillin, alleging that they had discovered construction defects arising out of the construction of their homes. McMillin tendered defense of the homeowners' lawsuit to the subcontractors' insurer, who refused to defend based on the language of the additional insured endorsements, which provided coverage for "liability arising out of [the subcontractor's] ongoing operations performed for [McMillin]."

In the ensuing coverage lawsuit, the insurer argued that there was not potential coverage for the construction defects until after the close of escrow of each homeowner's property and, thus, McMillin could have no potential liability for property damage that took place while the subcontractors were working on the project. The trial court agreed and granted summary judgment for the insurer, holding that because the homeowners did not own the allegedly defective homes until after the subcontractors' work was completed, any potential liability arising out of such work did not fall under the additional insured endorsements because it arose out of the subcontractors' completed—not ongoing—operations.

The appellate court rejected this argument, finding that it conflicted with the plain language of the additional insured endorsements, which granted coverage for any liability "arising out of" ongoing operations, not "during" such operations as the insurer claimed. Therefore, "the fact that there were no homeowners in the Project at the time [the subcontractors] ceased ongoing operations does not logically establish that the complaint in the underlying action did not subject McMillin to potential 'liability arising out of [the subcontractors'] ongoing operations performed for [McMillin].'" Because the insurer had failed to establish that the homeowners' claim was not even conceivably covered by the additional insured endorsements, the trial court erred in granting summary judgment.

The appellate court's reversal based on a broad interpretation of additional insured coverage arising from subcontractors' "ongoing operations" is favorable for parties trying to mitigate construction defect exposure using additional insured language in subcontractor liability policies and is the second appellate decision in as many months to reject insurer attempts to narrowly construe additional insured coverage. *See Pulte Home Corp. v. Am. Safety Indem. Co.,* 223 Cal. Rptr. 3d 47 (Ct. App. 2017). Decisions such as *McMillin* serve as a reminder that owners, contractors, design professionals and other parties to construction contracts should carefully evaluate not only the insurance requirements in the underlying

contract documents, but also the actual policy language and any additional insured endorsements effectuating such requirements to extend coverage to third parties. Further, in the event of an insurance coverage dispute, like the general contractor in *McMillin*, insureds should challenge any purported coverage defense that does not comport with the plain language of the insurance policy, especially where the policy imposes a broad duty to defend on the insurer (as is the case in most construction disputes involving general liability policies).

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