

## Additional Insureds: What Does “Arising Out of the Operations” Mean?

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Many contracts call for one company to add another company as an additional insured on a policy of insurance. This is common in the construction industry. It is also common in several other circumstances. For example, a shopping centre owner may require its security contractor and maintenance contractor to add the owner as an additional insured.

Usually, the insurance policy covers the owner’s liability “arising out of the operations” of the contractor.

### ***Purpose of Additional Insured Endorsement***

In [\*Sky Clean Energy Ltd. \(Sky Solar \(Canada\) Ltd.\) v. Economical Mutual Insurance Company\*](#), 2020 ONCA 558 (“*Sky Clean*”), the Ontario Court of Appeal noted that the inclusion of the owner under the contractor’s commercial general liability policy is an efficient and cost-effective way of allocating risks that arise out of the contractor’s operations under the contract.

If a claim arises, the owner can claim a defence and indemnity under the contractor’s policy, eliminating the need to claim under its own liability insurance policy.

### ***Remedies for Insufficient Coverage***

Despite the wording of a contract between the owner and a contractor, the language of the insurance policy governs.

In *Sky Clean*, the Court of Appeal stated that, if the coverage obtained by the contractor is not as broad as what the contract called for, the owner’s remedy may be against the contractor, either for indemnity under the contract or for breach of the contractual promise to obtain the specified coverage.

The Court of Appeal indicated that an owner who expects to be an additional insured should obtain a copy of the insurance policy and the additional insured endorsement, not just the certificate of insurance, to ensure that the appropriate coverage is in place.

### ***Arising Out of the Operations***

One frequent area of contention is whether a claim against an owner arose out of the operations of the contractor.

Fault on the part of the contractor is not required for coverage to the owner to be engaged, unless specified in the insurance policy. However, there must be a sufficient connection between the claim in question and the contractor's operations.

In *Sky Clean*, the Court of Appeal stated that the phrase "arising out of the operations" requires more than a "but for" connection between the liability of the additional insured and the operations of the named insured. A "but for" connection is necessary but is not sufficient. There must be an unbroken chain of causation. Further, the connection cannot be "merely incidental or fortuitous".

In addition, the word "operations" does not necessarily imply an active role by the named insured (contractor) in the creation of the liability event. "Operations" includes the creation of a situation or circumstance that is connected in some way to the alleged liability.

The question that must be asked is: "why did the additional insured's liability arise?"

For example, the Court of Appeal referred to a case where the plaintiff alleged that she slipped on a wet floor at a grocery store. The store owner had contracted with a janitorial company to maintain the floor. The store owner was added as an additional insured on the contractor's insurance policy, but "only with respect to liability arising out of the operations of the Named Insured".

The factual allegations of negligence against the store owner related to unsafe conditions left by the floor cleaning operators. Since the store owner's liability resulted from the contractor's alleged failure to perform its contractual obligations, the insurer of the janitorial company was required to defend the store owner.

Therefore, at the duty to defend stage, in examining the pleadings, one has to consider:

- Is there at least a "but for" connection between the allegations of negligence against the additional insured and the operations of the named insured? In other words, but for the operations of the contractor, would the allegations of negligence against the

owner have been made?

- Is the connection more than merely incidental or fortuitous?
- Does the claim allege an unbroken chain of causation, or is there an allegation of an intervening event that is outside the scope of the contractor's operations?

It should also be noted that an insurer has a duty to defend where there is a "mere possibility" that the true nature of the pleaded claim, if proven at trial, falls within coverage and would trigger the insurer's duty to indemnify: *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33.

### **Conclusion**

An owner who is added as an additional insured under a contractor's insurance policy should obtain and review the insurance policy and the additional insured endorsement to ensure that the contractor obtained proper coverage as required by the contract.

If the contractor obtained coverage that is not as broad as what the contract called for, then the owner may have a remedy against the contractor for indemnity under the contract or for breach of contract.

Many insurance policies will cover an additional insured for liability "arising out of the operations" of the named insured. In determining whether the additional insured is entitled to coverage, the key question to ask is: why did the additional insured's liability arise?

A "but for" connection between the liability of the additional insured and the operations of the named insured is required, but is not sufficient. There has to be an unbroken chain of causation and a connection that is more than "merely incidental or fortuitous".

Therefore, if there is only a very tenuous connection between the alleged liability of the owner and the operations of the contractor, coverage may not be available to the owner from the contractor's insurer.

However, at the duty to defend stage, the test is whether there is a mere possibility that the claim falls within the insurance policy, based on the pleadings.

As a result, in many cases, the insurer of the contractor will have a duty to defend the owner, and a closer examination of whether the owner's liability actually arose out of the contractor's operations, and whether there is a duty to indemnify, has to be left for trial or another hearing in which factual determinations on causation are made.