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Closing a habitability exclusion loophole

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Habitability claims filed by a tenant or group of tenants based on substandard living conditions present possibly the greatest liability risk faced by residential landlords. Many commercial general policies include various forms of "habitability exclusions." Nonetheless, creative policyholder lawyers have often been able to obtain a defense of habitability cases, even in the face of such exclusions where the tenant-plaintiff alleges other covered claims, such as invasion of privacy or wrongful entry.

However, in *24th & Hoffman Investors, LLC v. Northfield Ins. Co.*, 2022 DJDAR 9465 (Aug. 30, 2022), the California Court of Appeal, First Appellate District, cut off the right to a defense in such a case based on the particular language of the exclusion at issue. In doing so, the court rejected the reasoning of two federal district courts and created an issue which may be ripe for California Supreme Court review.

Northfield Insurance Company issued a commercial general liability policy to 24th & Hoffman Investors, LLC, which owned an apartment complex. Two tenants alleged multiple habitability claims against the landlord, complaining of substandard conditions caused by renovations at the property, such as construction debris and dust, as well as pest and vermin infestations. The tenants also alleged two claims that did not arise from the duty to provide habitable premises, namely conversion and trespass to chattels, which were based on alleged damage to the plaintiffs' personal property stored in a locker at the complex.

Northfield refused to defend the case based on its habitability exclusion, which excluded not only claims "arising out of the … actual or alleged violation of any federal, state or local law, code regulation, ordinance or rule relating to the habitability of any premises," but any causes of action "alleged in any claim or 'suit' that also alleges any violation, breach or wrongful eviction, entry or invasion as set forth … above." (Emphasis added). Given the inclusion of non-habitability claims in the underlying complaint, the effect of the second "catch-all" clause was at the heart of the dispute.

After defending and settling the underlying case on its own, the landlord sued Northfield for wrongfully denying coverage. The trial court found that Northfield breached its duty to defend in light of the non-habitability claims. This was in accordance with the rule established by the California Supreme Court *in Buss v. Superior Court*, 16 Cal.4th 35 (1997), that in a "mixed" action where some claims are potentially covered and others are not, the insurer must defend the entire action, subject to a right to partial reimbursement of defense costs following the conclusion of the case.

The Court of Appeal reversed, finding that Northfield had contracted out of the *Buss* rule by including clear language in its exclusion applying to any claims alleged in a suit that "also" included habitability claims. Since there were no other published California cases dealing with such language in a habitability exclusion, the court relied on *S.B.C.C., Inc. v. St. Paul Fire & Marine Ins. Co.*, 186 Cal.App.4th 383 (2010), which included similar catch-all language in an intellectual property exclusion, barring coverage for "any other injury or damage that's alleged in any claim which also alleges any such [intellectual property] infringement or violation." (Emphasis added). However, the underlying complaint in *S.B.C.C.* did not include otherwise covered claims.

Recognizing the paucity of California cases on point, the court cited a number of federal district court decisions upholding exclusions with similar catch-all clauses, mostly in intellectual

property exclusions. The court also addressed two federal district court opinions which rejected the insurers' reliance on similar and – in one of the cases – identical catch-all exclusions.

In *Saarman Construction, Ltd. v. Ironshore Specialty Insurance Co.*, 230 F.Supp.3d 1068 (N.D. Cal. 2017), the insured tendered an action brought against the insured for negligent repair work resulting in water damage to the underlying plaintiff's property, including mold damage. The policy contained a mold exclusion precluding coverage for "any claim, demand, or 'suit' alleging … Bodily Injury, [or] Property Damage' … arising out of, in whole or in part, the actual, alleged, or threatened … existence of any mold." Finding that *Buss* prevented insurers from "contract[ing] around their duty to defend mixed actions in this way," the district court rejected the argument that the exclusion barred a defense given the presence of allegations that did not depend on mold.

The second case, *Conway v. Northfield Ins. Co.*, 399 F.Supp.3d 950 (N.D.Cal. 2019), was even more on point, construing the identical habitability exclusion. The tenant-plaintiff in the underlying case alleged claims both as to her residential premises and her commercial premises. Notwithstanding the catch-all clause in the habitability exclusion, the *Conway* court found a duty to defend, reasoning that "the mere fact that a habitability issue may exist in a complaint is insufficient to satisfy the exclusion." Notably, following the ruling in *Conway*, the parties entered into a settlement, pursuant to which they stipulated to vacate the decision. The district court refused that request, however, finding: "While the Court recognizes that judicial policy generally favors settlement, here, that interest is outweighed by the Court's concerns over vacating a summary judgment order that addressed developing areas of law and may be useful to the public." *Conway v. Northfield Insurance Company*, 2019 U.S. Dist. LEXIS 135867 (N.D.Cal. August 12, 2019).

The *24th & Hoffman* court was unpersuaded by either *Saarman* or *Conway*, declining to follow those non-binding cases. Reiterating that "an insurer is free to limit the risk it assumes by contract," the court found that none of the causes of action were potentially covered in light of the plain terms of the exclusion because the non-habitability claims "are alleged in a suit that also alleges habitability claims." (Emphasis added). According to the court, its conclusion did not run afoul of *Buss* because the habitability exclusion rendered *Buss* irrelevant, since none of the claims were potentially covered.

The court recognized "the oddity of an insurance contract that covers certain claims against the insured if those claims are filed in a lawsuit of their own, and not if such claims are brought in a suit that also alleges habitability claims." However, since that is what the clear language of the exclusion required in the court's view, that was its holding.

It should be noted that the catch-all clauses in both *24th & Hoffman* and *S.B.C.C.* expressly used the term "also" (emphasized above) to exclude otherwise covered claims appearing in a suit "that also alleges" uncovered claims. Not all habitability exclusions contain such direct language. Many include language more akin to the mold exclusion in *Saarman*, which the district court found did not bar a defense given the presence of non-excluded claims.

More fundamentally, the *24th & Hoffman* case raises the question of whether insurance companies can contract out of *Buss*. In finding that they cannot, the *Saarman* court pointed out that the obligation to defend "is not even rooted in the contractual language itself, but rather is 'imposed by law in support of the policy.'" The *Saarman* court also noted that, pursuant to *Buss*, "the claim, and not the entire lawsuit, is the proper unit of analysis for determining whether the duty to defend is triggered." Accordingly, *24th & Hoffman* represents a direct challenge to the rule laid down by *Buss*, and thus is an appropriate subject for review by the California Supreme Court.

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