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# Chinese Drywall: Background, Scope, and Insurance Coverage Implications

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# INTRODUCTION

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- Why was Chinese drywall used?
  - Housing boom in the years 2004 to 2006
  - Hurricane damage leading to rebuilding of homes
  - Construction material shortage
- What is wrong with it?
  - “Rotten egg-like” odor
  - Corrosion of metal (copper, copper alloys and silver) and structural and mechanical systems
  - Health problems alleged

# PRESENTATION OUTLINE

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- Chinese Drywall Background
  - The Scope of the Problem
  - What is Drywall?
  - The Chinese Drywall Litigation
  - The Testing of Chinese Drywall
  - Federal Legislation
  - Remediation
- Coverage Analysis
  - First Party Property Claims
  - Third Party Liability Claims

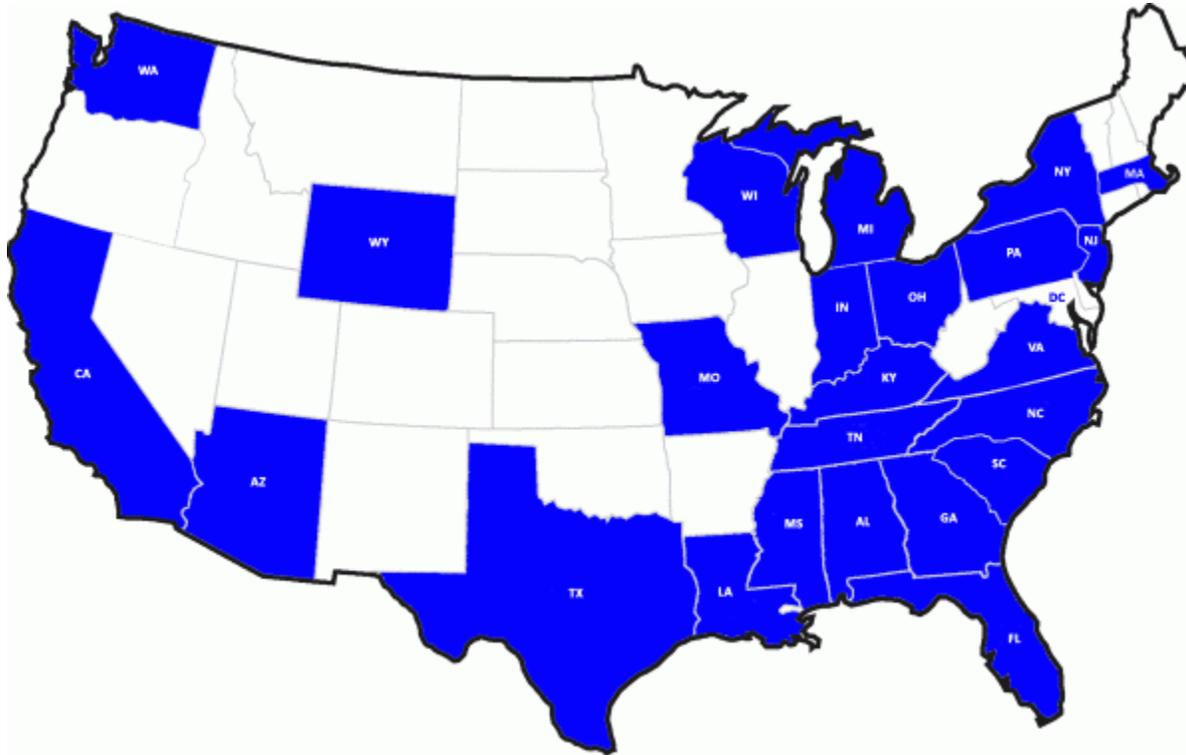
# SCOPE OF THE PROBLEM

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- As of the end of August, the Consumer Product Safety Commission (CPSC) had received a total of 1,192 incident reports from property owners in 24 states and the District of Columbia related to the allegedly tainted Chinese drywall. The majority of the reports have come from Florida, Louisiana, and Virginia.
- Recent Navigant Consulting Report
  - 518 million pounds of drywall imported from China between 2004 and 2008
  - 36,000 homes potentially affected

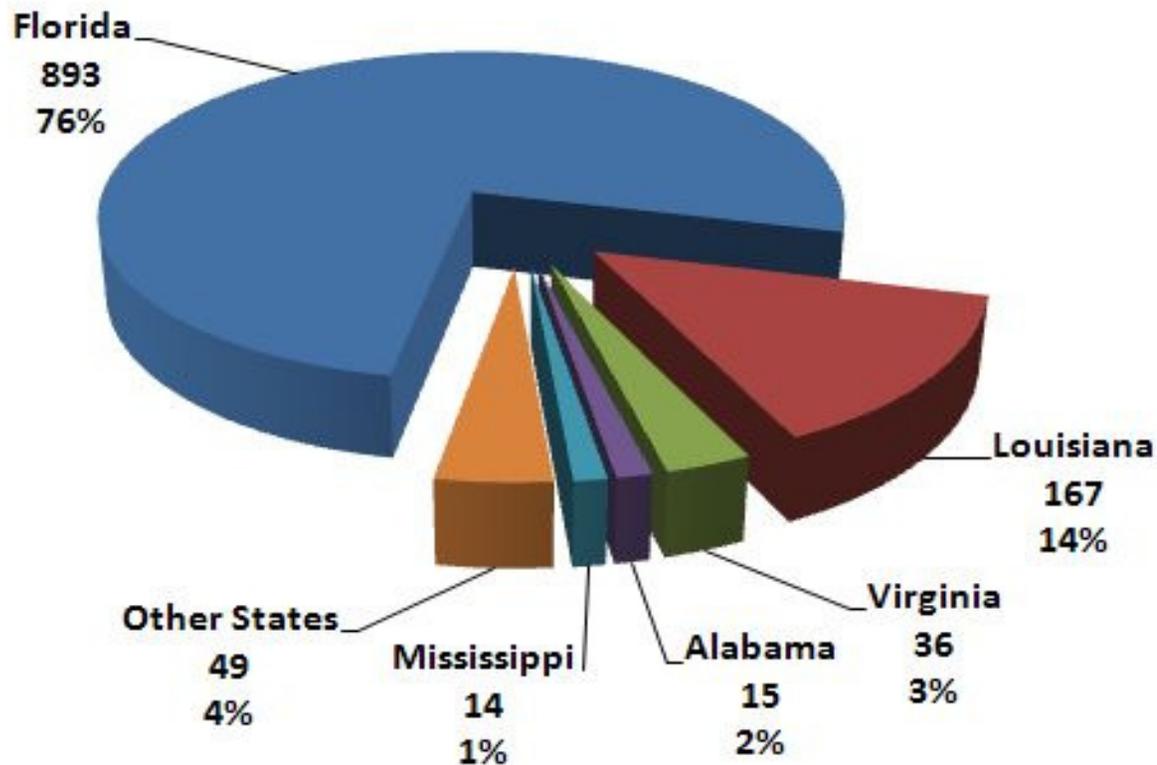
# STATES THAT HAVE REPORTED CHINESE DRYWALL COMPLAINTS



Information obtained from the U.S. Consumer Product Safety Commission at

<http://www.cpsc.gov/info/drywall/where.html>

# NUMBER (AND PERCENTAGE) OF CHINESE DRYWALL REPORTS BY STATE



Information obtained from the U.S. Consumer Product Safety Commission at <http://www.cpsc.gov/info/drywall/where.html>

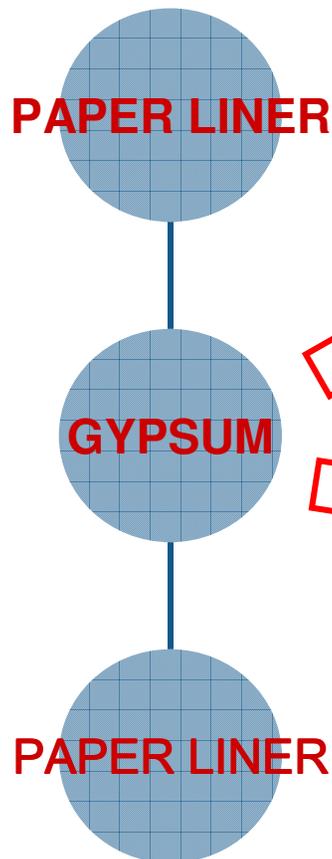


# PLASTER OF PARIS



Source: <http://www.patelpulverising.com/full-images/672229.jpg>

# WHAT IS DRYWALL? A/K/A GYPSUM BOARD, WALLBOARD, PLASTERBOARD, SHEETROCK, AND GYPROC



- Natural gypsum mined in many locations throughout the world.

- Synthetic gypsum produced as a byproduct of coal fired power plants.

# SO WHAT IS DRYWALL?

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- Gypsum:
  - Calcium Sulfate Dihydrate ( $\text{CaSO}_4 \cdot 2\text{H}_2\text{O}$ )
  - Trace Materials and Unreacted Sorbents
  
- Two layers of paper

# THE LITIGATION



- Numerous individual and class action lawsuits brought by homeowners.

- UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF LOUISIANA

IN RE: CHINESE-  
MANUFACTURED DRY WALL  
PRODUCTS LIABILITY  
LITIGATION

MDL NO. 2047  
SECTION: L  
JUDGE FALLON  
MAG. JUDGE WILKINSON

- A handful of first party claims filed to date.



# ALLEGATIONS

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- Chinese drywall contains excess levels of sulfur.
- Under certain environmental conditions, it emits hydrogen sulfide and other sulfide gases.
- Gases create noxious “rotten-egg like” odor.
- Causes damage and corrosion to, *inter alia*, home mechanical systems such as air conditioner and refrigerator coils, copper tubing, and electrical wiring.
- Causes allergic reactions, coughing, respiratory and sinus problems, throat infections, eye irritation, and nosebleeds.

# CHINESE MANUFACTURED DRYWALL



# CHINESE MANUFACTURED DRYWALL



# DISCOLORED COPPER REFRIGERANT LINE



# WIRING WITH BLACK DISCOLORATION



# BLACK DISCOLORATION ON CANDLESTICK BASE



# MANUFACTURERS

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- Knauf Gips KG
  - Knauf Plasterboard (Tianjin) Co., Ltd.
  - Knauf Plasterboard (Wuhu) Co., Ltd
  - Knauf Plasterboard (Dongguan) Co., Ltd.
- Taishan Gypsum Co., Ltd. (f/k/a Shandong Taihe Dongxin Co., Ltd.)
- Others unknown

# DISTRIBUTORS AND SUPPLIERS



- Rothchild International Ltd.
- USG Corporation
  - L&W Supply Corporation d/b/a Seacoast Supply
- Banner Supply Co.
- La Suprema Trading, Inc.
- La Suprema Enterprise, Inc.
- Black Bear Gypsum Supply, Inc.
- Interior & Exterior Building Supply
- Rightway Drywall, Inc.
- Independent Builders Supply Association, Inc.
- Numerous local building supply outlets

# BUILDERS

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- Lennar Corporation
  - Lennar Homes, LLC f/k/a Lennar Homes, Inc. and U.S. Home Corporation
- Taylor Morrison, Inc. f/k/a Taylor Woodrow, Inc.
- Touse Homes, Inc. f/k/a Engle Homes
- WCI Communities, Inc.
- South Kendal Construction Corporation
- Numerous small homebuilders

# MULTIDISTRICT LITIGATION



- On June 15, 2009, a special panel on multidistrict litigation ordered federal actions involving liability for Chinese drywall consolidated in the U.S. District Court for the Eastern District of Louisiana under MDL No. 2047.
- Judge Eldon E. Fallon has been appointed to manage the MDL proceedings.

# REPORTED TESTING

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- United States Environmental Protection Agency Findings:
  - Sulfur detected in Chinese Drywall
  - Strontium detected in the Chinese drywall at twice to ten times the amount found in U.S. made drywall
  - Iron concentrations significantly higher in Chinese drywall

# REPORTED TESTING

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- U.S. Consumer Product Safety Commission has tested drywall samples, finding that neither the imported nor domestic drywall tested posed a radiological concern.

# REPORTED TESTING



- Unified Engineering, Inc. hired by the Florida Department of Health found strontium sulfide in the Chinese drywall that gave off a “distinct sulfur odor” when heated. Unified could not reach a reliable conclusion on the source of the sulfur.
- EMSL Analytical, Inc. found that the cause of the off-gassing sulfur compounds was impurities in the Chinese drywall. Also reported potential microbiological component in the drywall which may be causing calcium sulfate to degrade into hydrogen sulfide.

# REPORTED TESTING



- The Center for Toxicology and Environmental Health hired by a manufacturer conducted air quality investigations and detected levels of sulfur-containing compounds in homes no greater than outside the homes.
- Environ International Corp. hired by Lennar Corp. confirmed that sulfur gases were capable of corroding copper and concluded that the level of gasses (carbon disulfide, carbonyl sulfide, and dimethyl sulfide) were within health and safety limits.

# FEDERAL LEGISLATION



- H.R. 1728 Mortgage Reform and Anti-Predatory Lending Act
  - H.AMDT.119 – directs the Secretary of Housing and Urban Development to study the impact of Chinese drywall on residential mortgage foreclosures
- H.R. 1977 Drywall Safety Act of 2009
  - Would mandate a CPSC study of Chinese drywall issues and impose interim ban on drywall exceeding 5% organic compounds
- Senate Resolution 91
  - Calling on CPSC, the Secretary of the Treasury, and the Secretary of Housing and Urban Development to take action on issues relating to Chinese drywall

# REMEDIATION

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- Several homebuilders have undertaken to replace the Chinese drywall installed in the homes they built.
- Some sources estimate the cost for replacement of the drywall would be approximately \$100,000 per home.
- To date, there is no established peer review protocol for repair of the damaged homes and contents.

# FIRST PARTY PROPERTY CLAIMS

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- Is there a physical loss of or damage to covered property?
  - Incorporation of the drywall into the dwelling?
  - Emission of sulfur-based gases?
  - Discoloration and corrosion of metals?

# TRIGGER OF COVERAGE

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- Majority view for first party progressive loss cases is that the policy on the risk at the time of manifestation of the damage is triggered.
- “Manifestation” is at the point in time when appreciable damage occurs and is or should be known to the insured.
- What constitutes “appreciable damage” is a question of degree and will likely be determined on a case-by-case basis.

# EXCLUSIONS

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- Inherent Vice
  - “any existing defects, diseases, decay or the inherent nature of the commodity which will cause it to deteriorate with a lapse of time.”
  - a cause of loss that “does not relate to an extraneous cause but to a loss entirely from internal decomposition or some quality which brings about its own injury or destruction.”

# EXCLUSIONS

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- Latent Defect
  - A defect that is hidden, or which could not have been discovered by any known or customary test or examination.
  - “Defect” relates to some structural weakness which is responsible for the damage or a condition of the property which renders it unfit for its intended purpose.

# EXCLUSIONS

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- Corrosion Exclusion
  - Courts across the country uniformly hold that “corrosion” is a physical condition that can occur at any time during the life of the property, and the rate at which the corrosion occurs is generally considered irrelevant.
  - Courts consistently reject any contention that language excluding loss caused by “corrosion” encompasses only damage by natural causes.

# EXCLUSIONS

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- **Faulty Materials Exclusion**
  - No coverage for losses caused by “faulty” materials.
- **Dampness or Temperature Changes Exclusion**
  - Precludes coverage for losses caused by “dampness” or changes in temperature.

# EXCLUSIONS

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- Pollution Exclusion
  - In general, pollution exclusions in first party policies are enforced.
  - However, application is dependent on jurisdiction.

# ENSUING LOSS EXCEPTION

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- For coverage under ensuing loss, an excluded cause must be followed by an independent and distinct peril which is otherwise covered under the policy.

# THIRD PARTY LIABILITY CLAIMS



## Causes of Action

- Negligence
- Strict Liability
- Breach of Warranties
- Breach of Contract
- Fraudulent Misrepresentation
- Fraudulent Concealment
- Violation of Unfair Trade Practices
- Private Nuisance
- Unjust Enrichment
- Equitable and Injunctive Relief

# DAMAGES

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- Plaintiffs seek the following damages:
  - Costs of inspection and replacement of the drywall;
  - Repair and replacement of other damaged or contaminated property in homes;
  - Renting of comparable housing during repair period;
  - Loss in the value of the homes; and
  - Environmental and medical monitoring for the class plaintiffs.

# TARGET DEFENDANTS

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- Manufacturers
- Distributors and Suppliers
- Builders

# IS THERE AN OCCURRENCE?

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- What is an “accident?”
  
- Can defective work or incorporation of defective materials constitute an accident?



# TRIGGER OF COVERAGE

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- Which potentially applicable policies are “triggered”?
- Dependent on jurisdiction, e.g.:
  - Florida law
  - Louisiana law

# MONTROSE ENDORSEMENTS

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- Coverage will cease for all subsequent policies once the insured learns of the continuing injury or damage. Also known as “known loss endorsements.”
- Known loss issue is jurisdictionally dependent.

# POLLUTION EXCLUSION



- Generally excludes coverage for bodily injury or property damage which would not have occurred but for the discharge of “pollutants” at any time.
- What constitutes “discharge,” “dispersal,” or “release.”
- Whether likely applicable to Chinese drywall claims dependent on jurisdiction.

# BUSINESS RISK EXCLUSIONS

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- Exclusions j.(5) and j.(6)
- Exclusion k. – “Your Product”
- Exclusion l. – “Your Work”
- Exclusion m. – “Impaired Property”
- Exclusion n. – “Sistership” or “Product Recall”

# CONTRACTUAL LIABILITY EXCLUSION



- In general, CGL policies exclude coverage for claims where insured assumes the liability of another under a contract or agreement.
- Application will require careful review of the terms of builder/contractor/subcontractor agreements and analysis of policy terms.

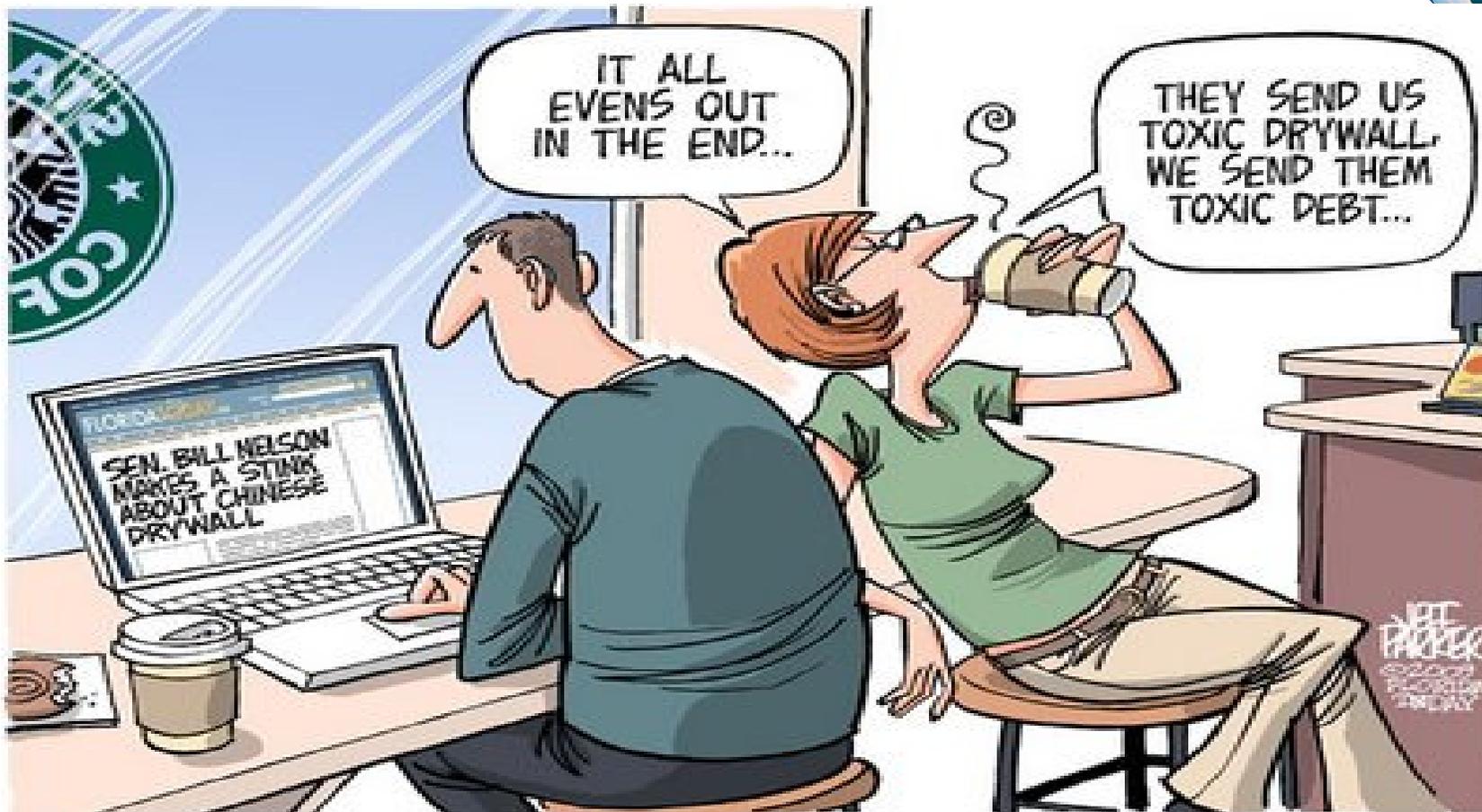
# CONCLUSION

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- Clearly, the Chinese drywall problem will have a significant impact on both liability and property insurance industries and warrants close monitoring.

# QUESTIONS?





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