



## **A PRIMER ON CHINESE DRYWALL ISSUES: BACKGROUND FACTS, LITIGATION, INSURANCE COVERAGES, & LEGISLATION**

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## AGENDA

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- Background.
  - What is Chinese Drywall?
  - What's the Harm?
- Chinese Drywall Litigation:
  - Who Are the Defendants?
  - Multi-District Litigation.
- General Theories of Liability.
- Insurance Coverage Claims:
  - First-Party Claims.
  - Third-Party Claims.
  - Policy Exclusions.
  - Litigation Update.
  - Conclusions So Far?



## AGENDA

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(con't)

- Handling Chinese Drywall Insurance Claims:
  - on-Renewing Policies.
  - Canceling Policies & Reducing Exposure.
  - Evaluating Policy Form Language.
  - Homeowners: Mitigating Damages.
- So Where Are We Now?
  - Federal Solutions.
  - State Solutions.
- Conclusion.





## THE BACKGROUND ON CHINESE DRYWALL



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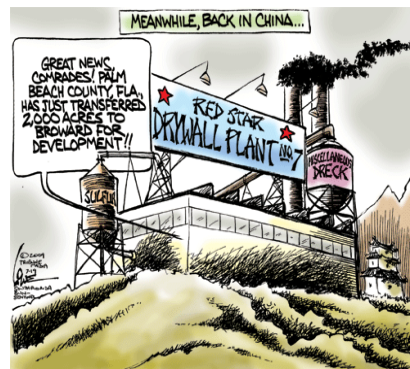
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## THE BACKGROUND ON CHINESE DRYWALL

### Background

- A drywall shortage occurred in the U.S. ("U.S.") following Hurricane Katrina.
- Approximately 555 million pounds of Chinese Drywall was imported from China to build more than 60,000 homes between 2004 and 2008 in the U.S.



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## THE BACKGROUND ON CHINESE DRYWALL

### Imported Chinese Drywall

- Of the U.S. imports, the Port of Miami received the largest number of Chinese Drywall shipments, totaling more than 100 million pounds.
- Port Everglades received 80 million pounds.
- Port of Tampa received 50 million pounds.



The Port of Miami in 2009



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## CHINESE DRYWALL

### Background (con't)

- In December 2008, the Consumer Product Safety Commissioner ("CPSC") first received complaints about failing HVAC coils in homes with Chinese Drywall.
- However, German-based manufacturer Knauf GIPS KG ("Knauf GIPS"), may have known about the problem in 2006 when it hired a company to test its drywall after receiving complaints of a smell emanating from the drywall.
- The testing company concluded that the drywall contained a "difference in smell," but no health risks.



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# CHINESE DRYWALL

## Background (con't)

- The CPSC first contacted the Florida Department of Health (“DOH”) on January 23, 2009, regarding defective Chinese Drywall.
- Authorities originally estimated that up to 100,000 homes could be affected nationwide. However, recent estimates project the number to be less than 50,000 (approximately 30,000).
- The majority of the homes are located in Florida, the Gulf Coast States, and Southeastern U.S.
- As of April, 2010, the CPSC reports receipt of 3,244 Chinese Drywall incident reports from 37 states, Washington D.C., Puerto Rico, and American Samoa.



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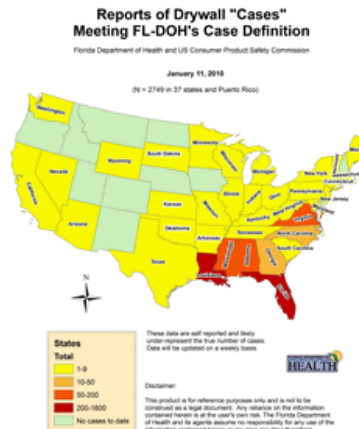
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# CHINESE DRYWALL

## Background

- Approximately 90% of claims are from five states, including:
  - Florida (59%);
  - Louisiana (20%);
  - Mississippi (6%);
  - Alabama (5%); and
  - Virginia (4%).



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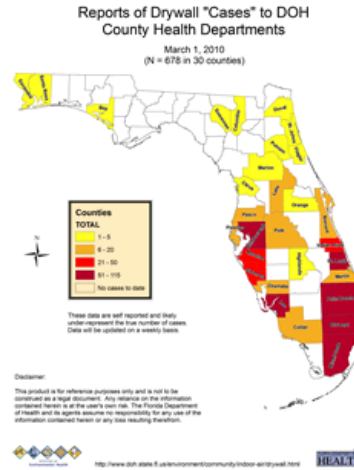
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# CHINESE DRYWALL

## Background

- In Florida, as of March 1, 2010, 30 counties and 678 homes reported Chinese Drywall problems.



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# CHINESE DRYWALL

## What is Chinese Drywall?

- Gypsum board is the generic name for a family of panel-type products consisting of core, primarily of gypsum, with a paper surfacing on face, back, and long edges.
- Gypsum is a mineral quarried from rock formations in a crystalline form known as calcium sulfate dehydrate.
- There is strong reason to believe that Chinese Drywall manufacturers mixed flyash, a form of "synthetic" gypsum which is a noxious industrial by-product of scrubbing smoke stacks from fossil burning plants, in with natural gypsum in the manufacturing process; early EPA tests bolster this theory.



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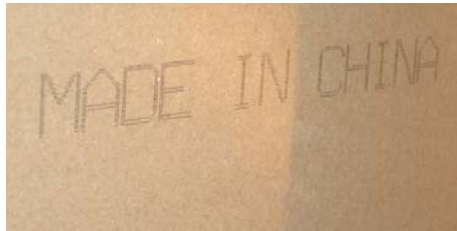
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## CHINESE DRYWALL

### What is Chinese Drywall? (con't)

- The stamp “Made in China,” on drywall may be indicative of defective Chinese Drywall, but not all drywall from China is defective.



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## CHINESE DRYWALL

### So What's the Harm?

- The theorized harm is that defective Chinese Drywall emits various gases when exposed to humidity for a period of time, including hydrogen sulfide and other sulfur-reducing compounds.
- Because hydrogen sulfide smells like rotten eggs, the presence of an odor may be indicative of defective Chinese Drywall.
- Another purported indication is the corrosion or discoloration of air conditioning coils, water pipes, and electrical wiring.



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## CHINESE DRYWALL

### So What's the Harm? (con't)

- Importantly, however, scientists studying this issue *have not* reached a consensus as to what causes the Chinese Drywall to release gases.
- Potential medical side effects may include: respiratory irritation, asthma, headaches, eye irritation, nose bleeds, coughing, and difficulty breathing.



## CHINESE DRYWALL

### Federal Investigations

- Presently, the CPSC is leading a federal drywall team investigation regarding the corrosion and health issues purportedly related to defective Chinese drywall.
- On October 29, 2009, the CPSC released its initial study results.
- Surprisingly, the report found that while the defective Chinese Drywall contained higher concentrations of bothersome chemicals, such concentrations, the study concluded, were not likely to cause the complained of health issues or physical degradation.







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## CHINESE DRYWALL LITIGATION



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## CHINESE DRYWALL LITIGATION

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### Chinese Drywall Litigation

- By September of 2009, there were an estimated 215 cases filed in federal courts, and 197 cases filed in state courts (with some overlap); however, the exact number of cases filed to-date is unknown.
- These actions generally name Chinese Drywall manufacturers, distributors, suppliers, and builders as defendants.



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## CHINESE DRYWALL LITIGATION

### Chinese Drywall: Federal Multi-District Litigation

- Federal Chinese Drywall lawsuits were filed in multiple federal districts across the U.S. and therefore fell within the purview of the Federal Rules of Civil Procedure governing Multi-District Litigation (a.k.a., “MDL”).
- MDL is a federal court procedure used to consolidate pending federal civil cases that have common questions of fact; this procedure allows one federal judge to manage pretrial procedures, discovery, and motions.



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## CHINESE DRYWALL LITIGATION

### Multi-District Litigation (con't)

- On June 15, 2009, the U.S. Judicial Panel on MDL in the U.S. District Court for the Eastern District of Louisiana initially transferred 10 defective Drywall actions to the E.D. of Louisiana under the Honorable Eldon E. Fallon.
- The actions included:
  - 4 actions from the Southern District of Florida;
  - 3 actions from the Middle District of Florida; and,
  - 1 action each from the Northern District of Florida, Eastern District of Louisiana, and Southern District of Ohio.



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## CHINESE DRYWALL LITIGATION

### Multi-District Litigation (con't)

- By virtue of the Transfer Order, hundreds of related pending cases in numerous federal districts were treated as “tag-a-long” actions, all involving complaints filed by homeowners and commercial property owners against manufacturers, installers, distributors, and home builders regarding the installation of defective Chinese Drywall and are non-insurance coverage cases.
- The initial 10 transferred cases will serve as “test trials” for defective Chinese Drywall litigation
- “Test trials” set benchmarks for appropriate damages, making settlements in other pending law suits more feasible.



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## CHINESE DRYWALL LITIGATION

### Multi-District Litigation:

#### *Germano v. Taishan Gypsum Co., Ltd.*

- The first case, *Germano v. Taishan Gypsum Co., Ltd.* (case no. 2:09-cv-6687), proceeded to trial on February 19, 2010. The case involved 7 families from Virginia seeking compensation for the costs of repairing corrosion in their homes.
- The primary issue was whether the homes containing defective Chinese Drywall must be completely gutted or, whether proper ventilation will do.
- **Case Decision:** On April 8, 2010, the court issued its ruling, awarding the families \$2.6 million in damages.



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## CHINESE DRYWALL LITIGATION

### Multi-District Litigation: *Germano* (con't)

- In addition, Judge Eldon issued a protocol for fixing homes, which includes removal and replacement of all drywall, electrical wiring, copper pipes, air conditioning systems, insulation, most appliances, cabinets, countertops, trim, crown molding, and baseboards. Affected homeowners should also receive temporary housing for 4-6 months.



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## CHINESE DRYWALL LITIGATION

### Multi-District Litigation *Hernandez v. Knauf Gips KG*

- On March 15, 2010, the second test case, but first real contested trial, got underway in *Hernandez v. Knauf Gips KG, et al.*, (case no. 2:2009-cv-0605).
- Tatum and Charlene Hernandez built a home in 2006 containing defective Chinese Drywall, which purportedly caused the air conditioner and other appliances to fail. After their homeowner's insurance denied their claim, the couple was forced to remain living in the home with their two children, despite suffering from respiratory problems and headaches.



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## CHINESE DRYWALL LITIGATION

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### Multi-District Litigation: *Hernandez* (con't)

- **Case Decision:** On April 27, 2010, the couple was awarded \$164,000 in damages, plus attorney's fees and court costs.
  - The judgment also requires the replacement of all drywall, ductwork, the entire electrical system, all copper and silver components, the HVAC system and all damages appliances and consumer electronics.
- **Next Up:** The next case, set for trial in June, involves a home that contains a mix of domestic drywall and defective Chinese Drywall, owned by Paul Clement and Celeste Schexnaydre.



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## GENERAL THEORIES OF LIABILITY



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## CHINESE DRYWALL LITIGATION

### General Theories of Liability Include:

- Negligence;
- Strict Products Liability;
- Breach of Warranty;
- Fraudulent Concealment;
- Private Nuisance;
- Breach of Contract;
- Vicarious Liability; and,
- Florida Deceptive and Unfair Trade Practices Act, Florida Statute, Section 501.201.



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## CHINESE DRYWALL LITIGATION

### Strict Liability

- Of particular concern is strict liability since typically, any person engaged in the stream of commerce (ranging from the manufacturer, to the wholesaler, to the retailer) can be held responsible if the product was defective and someone was injured.
- There is no need to prove negligence; the injured party must only prove that the product was defective.
- Thus, anyone involved in the stream of commerce of defective Chinese Drywall may be found liable to a consumer, without having any previous knowledge of the danger associated with Chinese Drywall.



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## INSURANCE COVERAGE: FIRST & THIRD PARTY CLAIMS



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## CHINESE DRYWALL INSURANCE LITIGATION

### **First-Party Claims: Trigger of Coverage**

- The first issue involved in a coverage analysis under a homeowner's policy for damage caused by defective Chinese Drywall is whether the damage constitutes a "direct physical loss" to the property. The damage must occur during the policy period to "trigger coverage" under a homeowner's policy.
- "Trigger of coverage" is a term of art referring to the event activating coverage under an insurance policy. There are four types of triggers of coverage which include: exposure, manifestation, continuous, and injury-in-fact theories. Even if coverage is triggered, a policy exclusion may apply.



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## CHINESE DRYWALL INSURANCE LITIGATION

### First-Party Claims: Policy Exclusions

- Common policy exclusions include:
  - Pollution or contamination exclusion;
  - Water damage exclusion (because of exposure to humidity);
  - Inherent vice exclusion for damage caused by mechanical breakdown;
  - Latent defect exclusion; and,
  - Inherent vice exclusion for any quality in property that causes it to damage itself.



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## CHINESE DRYWALL INSURANCE LITIGATION

### Third-Party Claims

- Commercial General Liability (“CGL”) policies are designed to protect an insured against certain losses arising out of business operations and provide for broad coverage for bodily injury claims brought by third-parties against an insured.
- The bodily injury in defective Chinese Drywall cases could be an injury related to the exposure to noxious gasses emitted by the defective drywall.
- A trigger of coverage or “occurrence” is required.
- A policy exclusion may prohibit the claim.



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## CHINESE DRYWALL INSURANCE LITIGATION

### Strongest Exclusion Likely to Bar Coverage: Pollution Exclusion

- The exclusion most likely to bar coverage is the Pollution Exclusion, which is contained in almost all third-party liability policies.
- The Pollution Exclusion generally bars coverage for claims for bodily injury and property damage “which would not have occurred in whole or in part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of ‘pollutants’ at any time.”



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## CHINESE DRYWALL INSURANCE LITIGATION

### Pollution Exclusion and Choice of Law

- Whether the Pollution Exclusion bars recovery in a particular case will be partially dependent upon which state law is applicable to the claim.
  - Florida will likely tilt favorably towards insurance companies because it applies the Pollution Exclusion broadly.
  - Louisiana applies it narrowly and will likely tilt more favorably towards the policyholders.
    - The fact that the Multi-District Litigation is pending in Louisiana may be cause for concern for insurers.



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## CHINESE DRYWALL INSURANCE LITIGATION

### Insurance Litigation Update: *Finger v. Audubon Ins. Co.*

- The first insurance coverage ruling in Louisiana state court was issued on March 22, 2010, in *Finger v. Audubon Ins. Co.*, (case no. 09-8071), by Civil District Court Judge Lloyd J. Medley, in New Orleans Parish.
- The Judge ruled that Audubon's "Pollution or Contamination" (POL), "Gradual or Sudden Loss" (GSL) and "Faulty, Inadequate or Defective Planning" (FIDP) exclusions could not be used as "affirmative defenses" to deny coverage in the case.



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## HANDLING CHINESE DRYWALL INSURANCE CLAIMS

### Issues Related to Insurance Coverage Cases

- Nonrenewing policyholders who file Chinese Drywall damage claims.
- Canceling homeowners policies once the defective Chinese Drywall risks are discovered.
- Undertaking efforts to reduce exposure.
- Mitigating damages and/or taking corrective measures.



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## CHINESE DRYWALL: FEDERAL SOLUTIONS

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### FEDERAL SOLUTIONS



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## CHINESE DRYWALL: FEDERAL SOLUTIONS

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### Federal Legislation

- In 2009, several bills regulating Chinese Drywall were introduced, but have progressed very little, including:
  - [S. 739/H.R. 1977](#): Drywall Safety Act of 2009;
  - [H.R. 1728/H. Res. 400/ H. Res. 406](#): Mortgage Reform & Anti-Predatory Lending Act;
  - [H.R. 4904](#), Drywall Victims Ins. Protection Act
  - [S. 2850](#), Chinese Drywall Homeowners Assist. Act;
  - [S. 2731](#), Small Business Admin. Disaster Recovery & Reform Act; See similar bills [H.R. 3743](#), [H.R. 3854](#), [H. Amdt. 492](#);
  - Resolutions: [S. Res. 91](#); [S. Res. 352](#); [H. Con. Res. 197](#).



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## CHINESE DRYWALL: FEDERAL SOLUTIONS

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### Federal Legislation (con't)

- In 2010, a few more bills regulating Chinese Drywall were filed, including:
  - [H.R. 4697/H.R. 4362](#): Would amend the Internal Revenue Code of 1986 to exclude from gross income remediation payments for hazardous drywall; and,
  - [H.R. 4881](#): Toxic Drywall Homeowner Relief Act of 2010.



## CHINESE DRYWALL: FEDERAL SOLUTIONS

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### STATE SOLUTIONS





## CHINESE DRYWALL: STATE SOLUTIONS

### State Actions: Louisiana (con't)

- SB 595 was filed in March 2010 in the Louisiana Senate and would prohibit insurance companies from increasing policy premiums and deductibles for businesses and homeowners due to the presence of Chinese drywall.
- The bill would also prohibit insurers from canceling and refusing to renew policies due to the presence of Chinese drywall, and also, from changing or dropping coverage.
- SB 595 passed the Senate on April 26, 2010, and will now be considered in the House.



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## CHINESE DRYWALL: STATE SOLUTIONS

### State Actions: Florida

- To date, Florida has not enacted legislation banning the use of Chinese Drywall. Several bills were filed during the 2010 Regular Legislative Session relating to defective Chinese Drywall, including:
  - SB 500, Reactive Drywall Mitigation Act;
  - SB 1042, Relating to Reactive Drywall;
  - SB 1044/HB 975, Relating to Reactive Drywall; and,
  - SB 2196/HB 1133, Relating to Agreements for Property Repairs and Reactive Drywall.
- None of the bills were passed into law when the Florida Legislature adjourned on April 30, 2010.



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## THE CONCLUSION?

### Still Too Early to Tell How Courts Will Handle Insurance Claims, But in the Meantime...

- Insurers must take necessary actions, including reviewing policy form language to analyze the strength of defenses under the plain language of policy exclusions. Upon receipt of Chinese Drywall insurance claims, insurers should consider filing for declaratory relief. Insurers should not outright non-renew or cancel policies based upon the presence of Chinese Drywall and should undertake efforts to actively investigate claims. Insurers are encouraged to communicate with regulatory officials regarding the Chinese Drywall problem.



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