

## CHINESE DRYWALL: THE BAD NEWS AND THE GOOD NEWS

There have been two important decisions on the Chinese drywall front in the past few weeks. For home builders, one was bad news, but the other was good. On the one hand, liabilities for Chinese drywall claims may be larger than expected. On the other, insurance should be available to off-set those liabilities.

### The Chinese Drywall Problem

From 2004 to 2006, during the housing boom and following several hurricanes, including Katrina, drywall manufactured in China was imported into the United States in large quantities and used in home construction mostly along the Gulf Coast, but as far north as Virginia and (in much smaller quantities) even beyond the Atlantic states. It is estimated that as many as 400,000 homes in the United States may contain Chinese drywall. Not long after the owners of homes built with this type of drywall moved into their homes, they claim they started to notice a sulphite or “bad eggs” odor. With the further passage of time, they began to complain about the blackening and corrosion of metal wiring and pipelines and the premature failure of appliances and electrical devices in their homes.

Thousands of affected homeowners in Florida, Virginia, Mississippi, Alabama and Louisiana filed suit in state and federal court against homebuilders, developers, installers, suppliers, importers and manufacturers involved with Chinese drywall. On June 15, 2009, the Judicial Panel on Multidistrict Litigation in Washington, D.C., transferred and consolidated all federal cases involving Chinese drywall to the U.S. District Court for the Eastern District of Louisiana, before Judge Eldon Fallon.

### First Trial Of Chinese Drywall Claims

On April 8, 2010, Judge Fallon issued a 108-page ruling in the multi-district litigation in Louisiana, following the February trial of Chinese drywall claims by seven families in Virginia. This was the first trial of such claims in the federal courts. Notably, it was a default trial so the court heard only the plaintiffs’ evidence. At the low end, Judge Fallon awarded damages of \$89,000 to a family with a home containing only eight boards of Chinese drywall used to build a wine storage room in their basement. At the high end, he awarded \$480,000 to the owners of a 3,055 square foot duplex close to the Atlantic Ocean, where all of the drywall and all of the wiring in the home had to be replaced. (The total cost of the remediation was \$312,000).

Judge Fallon’s decision may have a significant impact on the future resolution of Chinese drywall claims. His findings included the following:

- That appropriate remediation includes the removal and replacement of **all** drywall, **all** electrical wiring, the entire HVAC system, and many other items such as appliances, carpet, cabinetry, counter tops and flooring.
- That the only economically feasible option is to totally gut the structure and take it down to the studs. The only exception would be in the rare case where it is clear that the use of CDW was localized.
- That the cost of repairing Virginia Chinese drywall homes is on average \$86 per square foot.
- That homeowners are entitled to the cost of alternative living accommodation while their homes are being repaired, and that such repair will normally take from 4 to 6 months.

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- That all homeowners should receive loss of use and enjoyment damages. Judge Fallon awarded \$100,000 each to six of the seven Virginia families, and \$30,000 to the family with the CDW problem resulting from the wine room in their basement.

Judge Fallon awarded a total of \$2.6 million in damages to the seven Virginia families.

#### First Ruling On The Application Of the Pollution Exclusion To Chinese Drywall

While the federal court in the multidistrict litigation in Louisiana awarded significant damages to homeowners impacted by Chinese drywall, a Louisiana state court had just ruled that the pollution exclusion does not apply to Chinese drywall claims. *Finger v. Audubon* is the first decision of which we are aware dealing with the application of the pollution exclusion to Chinese drywall.

The Fingers had a homeowners policy with Audubon. The policy included the following exclusion:

“We do not cover any loss, directly or indirectly, regardless of any cause or event contributing concurrently or in any sequence to the loss, caused by the discharge, dispersal, seepage, migration or release or escape of pollutants . . . . A ‘pollutant’ is any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and ‘waste’ . . . .”

Although this exclusion was contained in a homeowners policy, it is not materially different from the pollution exclusion typically found in many commercial general liability policies purchased by businesses.

The *Fingers* court completely rejected the insurance company’s attempt to rely upon this provision to avoid liability. It found:

- That the exclusion does not, and was never intended, to apply to residential homeowners’ claims for damages caused by substandard building materials.
- That the fact that the Chinese drywall was releasing various gases into the home was not sufficient to qualify it as a “pollutant” under the pollution exclusion.

The *Fingers* court also ruled that the Audubon policy’s exclusion for “loss caused by inherent vice, wear and tear, mechanical breakdown or latent defect” did not apply: the losses were caused by drywall off-gasing, not by wear, tear and/or gradual deterioration, and there was no evidence that the drywall was damaging itself, so the “inherent vice” and “latent defect” language did not apply.

#### Insurance Coverage Should Be Available To Home Builders

The appellate courts in a majority of states (but not all states) have already ruled that the pollution exclusion -- even in the form of the so-called “absolute” or “total” pollution exclusion -- is intended only to preclude coverage for traditional environmental pollution that is the subject of federal and state environmental laws, and that it does not apply to claims arising from the indoor release of noxious substances or fumes. However, *Fingers* is the first case specifically to hold that the exclusion does not apply to Chinese drywall. Thus, while home builders could face liabilities for Chinese drywall, most developers and builders should, depending upon the application of state law, be able to obtain defense and indemnity under their commercial general liability, excess liability and (if they have them) pollution liability insurance policies.

*If you have any questions regarding liabilities for Chinese drywall and insurance coverage for such liabilities, please contact:*

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