

# Up Against A Chinese Drywall

## Recent Developments in the Ongoing Products Liability and Coverage Litigation

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# Chinese Drywall

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# Introduction

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- During the construction boom years of 2002-2007, including reconstruction efforts in the Gulf Coast states following the 2004 and 2005 hurricane seasons, a shortage of domestic drywall forced many builders to purchase and install drywall that was manufactured in China.
- Starting in late 2008, complaints were made that drywall:
  - Emitted gases that when mixed with high humidity levels corroded components of electrical and HVAC systems, and other fixtures and appliances
  - Emitted an unpleasant odor
  - Caused illness and physical symptoms

# Problem with Chinese Drywall

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- Florida Department of Health – Chinese drywall contains higher levels of impurities than (most) domestic drywall (sulfur, strontium sulfide, and acrylic paint)
- When exposed to high relative humidity or heat
  - Produces sulfur-containing gases
  - Can corrode copper piping and wiring and turns metal black
  - Causes appliances and electronics to fail (e.g. HVAC systems)
  - Smells of rotten eggs

# Scope of Problem

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As of mid October, 2009:

- Over 1,500 complaints to Consumer Product Safety Commission from 27 states and the District of Columbia.
  - 90+% of the complaints are from Florida (74% of total) and Louisiana (17% of total)
- Approx. 550 million pounds imported into the U.S. between 2002-2008.
  - 350 million pounds in Florida alone

# Scope of Problem

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- 6.21 million sheets of drywall have been imported into U.S. from China
- May be in as many as 100,000 homes nationwide, although predominately in Southeast (Florida, Louisiana, Alabama, Mississippi, Texas and Virginia)
- May have been recycled and used by U.S. manufacturers to make domestic drywall, increasing the scope of the problem
- Scope of the issue is still an open question

# Florida Dept. of Health Case Criteria

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- **Case Definition (03-31-09) for Premature Copper Corrosion in Residences Possibly Associated with the Presence of Imported Drywall from China.**

- First, determine the date of construction

To meet the current case definition (03-30-09) homes constructed after 2003 (2004 to present) must meet two or more conditions; and those built prior to 2004 must meet three or more of the conditions specified below.

- There is presence of sulfur-like or other unusual odors
- Confirmed presence of Chinese manufactured drywall in the home
- Observed copper corrosion, indicated by black, sooty coating of Un-insulated copper pipe leading to the air handling unit present in the garage or mechanical closet of home
- Documented failure of air conditioner evaporator coil (located inside the air handling unit)
- Confirmation by an outside expert or professional for the presence of premature copper corrosion on Un-insulated copper wires and/or air conditioner evaporator coils (inside the air handling unit)

# HVAC Suction Line

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# Circuitry Inside Appliances



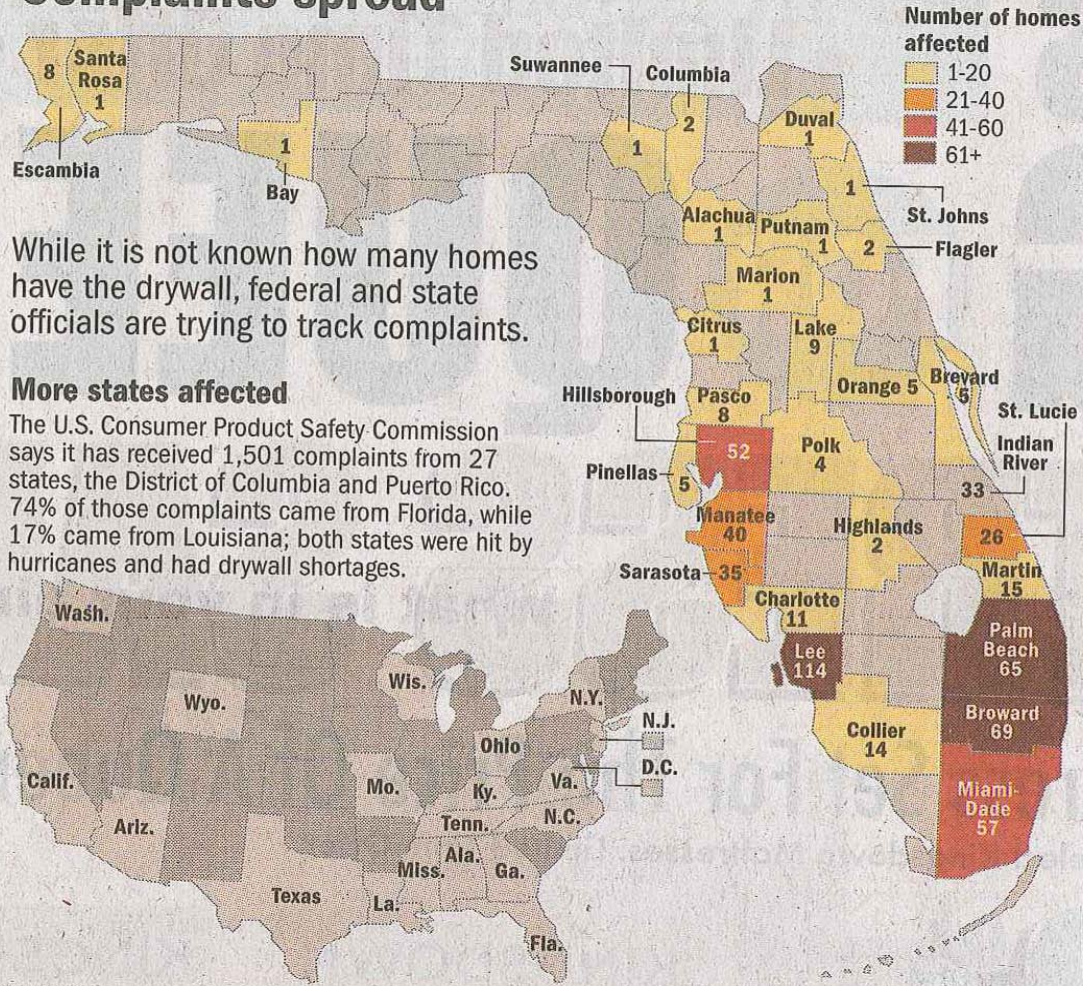
# Reports

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- 1,500+ reports, hundreds of lawsuits
- Allege property damage, bodily injury, and need for medical monitoring
  - Damage to electrical and HVAC systems, household fixtures and appliances; unpleasant odor makes home uninhabitable
  - Causes headaches, respiratory problems, burning eyes, other illnesses; no causal connection between defective drywall and illnesses
  - Requires monitoring effects of exposure

# Florida Reports

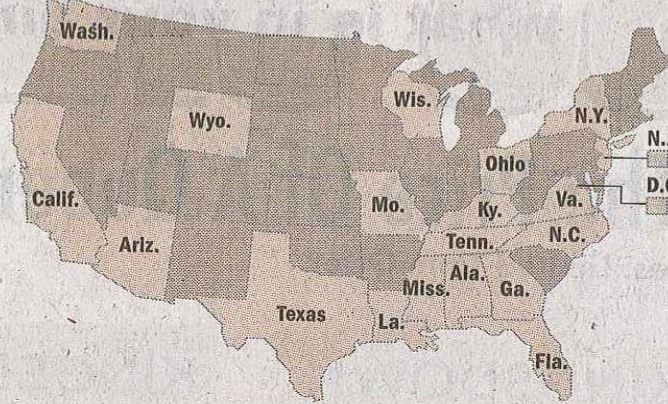
## Complaints spread



While it is not known how many homes have the drywall, federal and state officials are trying to track complaints.

### More states affected

The U.S. Consumer Product Safety Commission says it has received 1,501 complaints from 27 states, the District of Columbia and Puerto Rico. 74% of those complaints came from Florida, while 17% came from Louisiana; both states were hit by hurricanes and had drywall shortages.



Source: U.S. Consumer Product Safety Commission; Florida Department of Health

STAFF GRAPHIC

# Potential Damages

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- Bodily injury
  - Medical costs
- Ongoing medical monitoring
- Property damage
  - Costs of removing or replacing the drywall
  - Fixing associated damage (e.g., damage to HVAC systems, appliances, etc.)
  - Loss of use/temporary housing for displaced residents
  - Property values reduced

# Other Potential Costs

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- Litigation costs:
  - Defense attorneys' fees can be 40-50% of total claim cost;
  - Plaintiff's attorneys' fees may be recoverable
    - Louisiana, e.g., is plaintiff-friendly forum and legislation in state senate would allow homeowners to recover fees
- Increased exposure due to:
  - Insolvencies in the building industry
  - Failure to obtain jurisdiction over foreign defendants
  - Wrongdoers uninsured/underinsured and without assets
- Negative publicity
  - Including negative effect on stock prices of publicly traded companies (developers, etc.)

# Estimated Total Losses

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- Economic losses could reach \$25 billion

# Lawsuits

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- Lawsuits filed in numerous state and federal courts
  - Started in Florida
  - Spread to other states, including:
    - Louisiana
    - Virginia
    - Mississippi
    - North Carolina
    - Ohio

# Lawsuits

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- Currently there is a disconnect between number of claims/lawsuits and media reports
- 205 cases in the federal Multi-District Litigation
  - 332 Plaintiffs have submitted profile forms as of October 15, 2009
  - 197 cases on the State/Federal coordination list with some Plaintiff overlap
    - 132 of these state cases are in Florida
      - 62 in Palm Beach County
- Cases are still trickling in
- Some anecdotal reports of claimant attorneys holding on to “inventory”



# Lawsuits: Plaintiffs

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- Individuals
  - Homeowners
  - Residents and owners of condos, co-ops
- Condominium associations
- Builders
- Contractors/Subcontractors
- Companies suing other companies for indemnity, contribution (e.g., Lennar Corporation)

# Lawsuits: Defendants

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- Manufacturers - Targets
  - Knauf Gips and its Chinese division Knauf Plasterboard Tianjin
    - Chinese Division is the manufacturer, but German parent is the deep pocket owner over whom US plaintiffs want to get jurisdiction
  - Taishan Gypsum Co.
  - U.S. Gypsum
    - Products mixed with Chinese Drywall?
  - Importers, Exporters
  - Builders/Developers
  - Contractors
  - Suppliers
  - Retailers (Lowe's and similar sellers)
  - Anyone in the chain involved in home construction process is a potential target

# Lawsuits: Claims

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## Claims Asserted Include:

- Negligence
- Strict Liability
- Breach of Contract
- Breach of Warranty
- Unfair Trade Practices
- Consumer Fraud
- Major issue in existing litigation will likely be product identification and supply chain

# Lawsuits: Damages Sought

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- Property Damage Alleged:
  - Cost of Testing
    - Air
    - Ripping out walls to check name of manufacturer stamped on wall boards to see if it's an implicated Chinese manufacturer (total cost estimated in tens of thousands of dollars per home)
  - Replacement of walls (estimated at \$100,000 per home average)
  - Replacement of corroded pipes, wiring and appliances
    - A/C Units
    - Copper and silver components of electrical systems
    - Household fixtures and appliances
  - Loss of Use/Alternative housing costs
    - Smell allegedly makes homes uninhabitable
    - Uninhabitable while repair work going on
  - Diminution of property value
    - Hillsborough County, Florida property appraiser reportedly already accounting for presence of Chinese Drywall in property valuations. Others following suit.

## This Is What They Are Looking For



# Lawsuits: Damages Sought

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- Bodily Injury:
  - Exposure alleged to cause headaches, respiratory problems, burning eyes, fatigue, etc.
  - Anecdotal reports that symptoms alleviated when exposure ceases
  - EPA, CDC, Consumer Product Safety Commission and Florida Dept. of Health so far have not concluded there is causal connection
  - Experts so far caution too early to determine if any permanent long-term bodily injury

# Lawsuits: MDL

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- On June 15, 2009, the Multi District Litigation (“MDL”) Panel transferred ten federal lawsuits originally filed in Florida, Louisiana and Ohio with the United States District Court Eastern District of Louisiana for consolidated pretrial proceedings
  - The “Chinese-Manufactured Drywall Products Liability Litigation” MDL No. 2047
- As additional federal cases are filed, they also will be transferred to the MDL
  - MDL court conferences recently referred to over 1000 homes at issue in MDL litigation
- State lawsuits proceed separately, but with efforts by MDL to coordinate state actions with federal proceedings
  - Federal MDL Judge established a state MDL coordinating committee
  - State Judges are listening to federal MDL conferences

# Lawsuits: MDL

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- Judge Eldon E. Fallon is the MDL presiding judge. (He orchestrated the Merck/Vioxx litigation settlement for \$4.85 billion)
- Website created and contains orders: <http://www/laed.uscourts.gov/Drywall/Drywall.htm> Bi-weekly court conferences accessible to public via teleconference
- Court has begun to address chain of custody, service of and jurisdiction over foreign defendants, inspections, coordination of state cases
  - Discovery had begun; first deposition was taken last week
- Categorized cases into
  - Property damage only
  - Property damage and Bodily injury
- Plaintiff and defendant profile forms distributed
  - Steering committees contend there are 36 different markings on drywall potentially identifying problematic drywall
  - Seek insurance information
  - Seek identification of others in defendant's supply chain



# Lawsuits: MDL

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- Court recently ordered start of testing of homes in batches
  - Working on protocol so initial group only 30 homes
  - Judge Fallon wants all parties' buy in on protocol so that there are no evidentiary issues regarding the inspections
- Bellweather trials of claims for property damage only to begin by January 2010
  - 5 cases to be tried with one standby
    - Each side to select ten cases in which to conduct discovery
    - Thereafter, each select 5 cases for trial, and each side has 2 objections
- Possible difficulty in identifying property damage only cases
- Property damage/personal injury cases to begin later, anticipated in approximately one year
  - Involve unresolved issues and will likely take longer to try than PD only.

# Congressional Action

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- Bills introduced :
  - Drywall Safety Act of 2009:
    - Recall and ban the use of Chinese drywall in the United States and require the Consumer Product Safety Commission to analyze composition and effect of Chinese drywall
  - Mortgage Reform and Anti-Predatory Lending Act:
    - Study of availability of property insurance for allegedly contaminated homes

# Congressional Action

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- Critical issue in the MDL – jurisdiction over foreign defendants
- The Foreign Manufacturers Legal Accountability Act of 2009:
  - Easier to bring foreign companies before an American court
    - Foreign manufacturers must retain a business representative in at least one state where it does significant business and who could be served with a lawsuit
    - Foreign manufacturers to agree to be held accountable by U.S. courts if sued

# Congressional Action

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- Hearings on Chinese drywall to investigate the alleged health and product safety issues associated with Chinese Drywall
  - Senate Subcommittee on Consumer Protection Product Safety and Insurance held hearing hearings May 2009

# Investigations

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- Consumer Product Safety Commission is conducting multiple investigations regarding source, nature and extent of the problem
  - Analysis and findings of drywall sample testing due in November
  - Initial results possibly to be released at symposium in Tampa, Florida on November 5<sup>th</sup>-6<sup>th</sup>.
  - Reports that the investigations are behind schedule
  - No radiation risk to families in homes with Chinese drywall

# Effect of Bills/Investigations

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- Could trigger recall coverage
- Could demonstrate defect in product
- Could establish causal link between defect and bodily injury
- Congressional rhetoric that will make its way into claims, e.g. Sen. Nelson of Florida news release:

“We now know there are three things in there that aren’t in other drywall samples. We’ve got the what, and now we need the why and how do we fix it? In the end, I think all this stuff is going to have to be ripped out.”

# Policies Potentially Implicated

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- Types of Policies, potentially implicated primarily:
  - CGL
  - Builders Risk
  - Homeowners
- Also potentially implicated:
  - Environmental/Pollution Event Coverage Liability
  - Professional Liability
  - Even D&O

# Insurance Coverage Litigations

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- Insurance coverage actions have been filed and more expected
  - Three leading coverage cases at this time
    - S.D. Fla. (CGL)
    - M.D. Fla. (Homeowners)
    - E.D. Va. (Builders Risk)
  - All have been tagged by the MDL
- Unclear at this point whether federal insurance coverage matters will be transferred to MDL for control by Judge Fallon
  - Judge Fallon focusing on rulings on claims and not coverage
  - Recent insurer coverage action filed in Florida federal court requests that it be allowed to proceed outside of MDL
    - Insurer is currently fighting this battle in the MDL
- Movement afoot to get coverage actions in MDL?



# General Coverage Issues

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- What policy period is implicated
- Is there an occurrence/covered professional services/covered peril
- Is the defendant an insured or additional insured
  - If an indemnitee of an Insured, is that indemnity obligation covered
  - If Named Insured promised to add defendant as an Additional Insured to its policy, was that done
- Whether all conditions to coverage are satisfied (notice, cooperation)
- Whether any policy exclusions apply
- Whether payments insured is asking its insurer to reimburse are covered damages
- Effect of other insurance

# CGL Coverage Considerations

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Pays sums Insured “becomes legally obligated to pay as damages” because of:

“bodily injury” or “property damage”

If

1) “bodily injury” or “property damage” is caused by an “occurrence”

2) BI or PD occurs during the policy period

“Occurrence” standard definition:

“an accident, including continuous or repeated exposure to substantially the same general harmful conditions”

# CGL Coverage Considerations

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- Is there an occurrence?
  - If claim between contractor and client for failure to meet specifications, breach of contract, breach of warranty, then there is a potential defense to coverage
    - Majority Rule is that construction defects constitute an occurrence only if they cause PD (or BI) to a third party and no coverage for faulty workmanship alone. *See LaMarche v. Shelby Mutual Insurance Co.*, 390 So. 2d 325, 327 (Florida 1980)

“The purpose of this comprehensive liability insurance coverage is to provide protection...for property damage caused by the completed product, but not for the replacement and repair of that product”

# CGL Coverage Considerations

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- If an occurrence, what is the number of occurrences?  
(And thus number of retentions and number of limits)
  - Each claim?
  - Each building? Each development?
  - Each purchase of Chinese drywall?
- Majority of courts look to cause of BI or PD
- Minority takes “effects oriented” approach:
  - Can mean each claim is separate occurrence
  - Louisiana has recognized this approach in past
  - Choice of law can be critical

# CGL Coverage Considerations

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- Which CGL policies triggered:
  - Use of product 2001-2008, so issue is which policy period(s) apply?
  - Policy language requires BI or PD “during the policy period”
- Depending on the facts involved, and the jurisdiction where suit is pending, there are several different “trigger of coverage” theories that may apply.
- 1) **Exposure**: property damage occurs upon installation of the defective product.
- 2) **Manifestation**: property damage occurs at the time damage manifests itself or is discovered.
  - *See Auto Owners Ins. Co. v. Travelers Cas. & Sur. Co.*, 227 F. Supp. 2d 1248, 1266 (M.D. Fla. 2002) (applying manifestation trigger to property damage claims arising out of defective construction project).
- 3) **Continuous trigger**: considers property damage as occurring continuously from the time of installation until the time of discovery.
- 4) **Injury-in-fact**: looks at when the property damage underlying the claim actually occurs.

# Other CGL Coverage Considerations

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- Personal and Advertising Injury Coverage B
  - Definition can vary but often includes “wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by its owner, landlord, or lessor”
  - Some insureds are contending that homeowners/occupant complaints fall within “Personal Injury” coverage

# Other Policy Provisions That Give Rise to Issues

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- Are payments voluntarily made by an insured to remediate homes with Chinese Drywall “sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies”?
- Clauses requiring insurer’s prior consent to payments, assumption of obligations and incurring expenses

# Pollution Exclusions

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- The most popular coverage issue to date is the potential application of the **pollution exclusion**
- This issue has broad applicability across many product lines
- Policy language can vary, but pollution exclusions often define “Pollutant” as:
  - “any solid, liquid, gaseous, or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acid, alkalis, chemicals and waste. Waste includes material to be recycled, reconditioned or reclaimed.”



# Pollution Exclusions

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- Pollution Exclusions (contained in many policy types and forms)

- Main issue cited by Insurers

- Whether fumes emitted by Chinese drywall constitute a pollutant or contaminant within scope of pollution exclusion, or within scope of grant of coverage under Pollution Liability Policy

- Policy language can differ, but commonly pollution exclusion/event refers to:

“bodily injury” or “property damage” arising out of the actual alleged or threatened discharge, dispersal, seepage, migration, release or discharge of “pollutants” (with specified exceptions such as hostile fire)

Pollutant: any solid, liquid, gaseous or thermal irritant, including smoke, vapor, soot, fumes, acid, alkalis, chemicals and waste. . .”

# Pollution Exclusions

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- States differ on the breadth and scope of pollution exclusions
- Narrow Approach: Some courts have limited the exclusion's applicability to the industrial environmental pollution context
  - *Doerr v. Mobil Oil Corp.*, 774 So. 2d 119, 130 (La. 2000) (holding that pollution exclusions are intended to exclude coverage for active industrial polluters, when businesses knowingly emitted pollutants over extended periods of time)
  - *Stoney Run Co. v. Prudential-LMI Commercial Ins. Co.*, 47 F.3d 34, 37 (2d Cir. 1995) (holding that pollution exclusions are to be construed "in light of [their] general purpose, which is to exclude coverage for environmental pollution")

# Pollution Exclusion

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- Broader approach: In other states, courts have taken a more expansive view of the scope of exclusion
  - *Deni Assoc. of Florida, Inc. v. State Farm Fire & Cas. Ins. Co.*, 711 So. 2d 1135, 1138 (Fla. 1998) (Holding that the application of the pollution exclusion in CGL policies is not restricted to environmental or industrial pollution)
- A particular state's approach to the definition of "pollutant" will have a bearing on the exclusion's applicability
- **Choice of law and forum are potentially critical threshold considerations in these matters**
  - Critical consideration: Will coverage actions proceed in MDL?

# Pollution Events

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## Note:

Pollution event excluded under CGL policy may be covered event under pollution liability policy, but scope of pollution exclusions under CGL and covered pollution event under EIL policy may not be the same and there could be gaps

# Other Potential Exclusions – Particularly in CGL Context

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## “Your Work Exclusion” (CGL)

- The “Your work” exclusion states that the policy does not apply to:
  - Property damage to “Your work” arising out of it or any part of it and included in the “products-completed operations hazard.”
  - “Your work” is defined as:
    - (1) Work or operations performed by you or on your behalf; and
    - (2) Materials, parts, or equipment furnished in connection with such work or operations.
- But the exclusion “does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.”
  - Note: The “subcontractor exception” may be eliminated by endorsement in some policies.

# Other Potential Exclusions – Particularly in CGL Context

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- Damage to “your product” arising out of or any part of it
- Damage to Impaired Property
  - Tangible property that cannot be used or is less useful because it:
    - “incorporates your product or your work that is known or thought to be defective, deficient, inadequate or dangerous . . . If such property can be restored to use by the repair, replacement, adjustment or removal of “your product” or “your work”
- Recall (if recall issued)
  - Excludes damages for any loss, cost or expense incurred by insured or others for loss of use, withdrawal, recall, inspection, repair, replacement, adjustment, removal or disposal of “your product” or “your work” or “impaired property”
  - If it’s withdrawn or recalled from the market or from use because of known or suspected defect, deficiency, inadequacy or dangerous condition in it

# Other Potential Exclusions – Particularly in CGL Context

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- Expected or Intended PD or BI  
“from the standpoint of the insured”
- Contractual Liability
  - Exception for liability insured would have in absence of contract
  - Exception for “insured contract” executed before BI and PD occurs  
“Insured contract” is that part of any other contract pertaining to your business under which you assume the tort liability of another for BI or PD to a third person.
  - Exceptions for certain aspects of indemnity of architects and engineers

## Other Potential Exclusions – Particularly in CGL Context *(Cont'd)*

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- Other types of Policies may have other types of exclusions, e.g.
  - Products exclusions in professional liability and pollution liability policies
- Other insurance clauses may play a role



# Choice of Law

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- Choice of Law
  - Choice of law can govern how issues are resolved and the application of a particular exclusion or other policy term
  - Depending upon the jurisdiction considering the choice of law, what law applies can depend upon:
    - The policy terms (i.e., express choice of law provisions)
    - The circumstances relating to the placement and delivery of the policy or policies
    - The jurisdiction with the dominant relationship to the parties

# Recap

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- Bodily Injury – Questionable without proof of causation
- Property Damage – Greatest exposure
  - Exhaustive testing could cost more than remediation
  - Loss of value of house
  - Repair costs
  - Possible government will mandate “all of this stuff [will have] to be ripped out”
- Who pays what will be a major issue among defendants
- Coverage issues unresolved
  - Where will coverage cases proceed?

# Thank You

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