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Client Alert

A report for clients and friends of the Firm July 2009

Chinese Drywall Litigation Heating Up

On June 15, 2009, the United States Judicial Panel on Multidistrict Litigation consolidated ten "Chinese drywall" actions in the United States District Court for the Eastern District of Louisiana. The Panel found that all of the actions "share factual questions concerning drywall manufactured in China, imported to and distributed in the United States, and used in the construction of houses; plaintiffs in all actions allege that the drywall emits smelly, corrosive gases." The Panel's order indicates that 67 related cases pending nationwide will be treated as potential tag-along actions, and thus are likely to be transferred to Louisiana as well.

By some estimates, nearly 100,000 homes could be affected by allegedly defective drywall manufactured in China and used to build homes in the United States. According to a recent article in the Wall Street Journal, the United States imported roughly 309 million square feet of drywall from China during the housing boom from 2004 to 2007. The wallboard was welcomed by homebuilders, who were suffering supply shortages due to the housing boom and construction in the wake of Hurricanes Katrina and Rita. Now, however, dozens of actions have been filed around the country against Chinese-based manufacturers, as well as importers, contractors, developers, suppliers and others, for property damage and personal injuries allegedly resulting from the Chinese drywall. It is estimated that in Florida alone around 15,000 plaintiffs have joined more than 150 Chinese drywall lawsuits. Some legal experts believe that more than 75,000 such lawsuits could be filed nationwide.

One putative class action filed in Florida state court, *Harrell v. South Kendall Construction Corp., et al.*, No. 09-08401CA40 (11th Jud. Cir., filed Feb. 3, 2009), appears to be procedurally ahead of the pack. Plaintiffs in that case assert that their home is "essentially uninhabitable" because it contains "defective drywall made in China sold, manufactured, distributed, imported and/or supplied by Defendants in violation of the law." Plaintiffs claim that the Chinese drywall emits toxins, including carbon sulfide, carbonyl sulfide and hydrogen sulfide, that damage homes, erode or corrode metal, disrupt or interfere with the operation of electronic equipment, and pose serious health risks, including headaches, respiratory ailments and other maladies. A class certification hearing is scheduled for September 2009, and the court likely will be the first in the country to decide whether class treatment of Chinese drywall claims is appropriate.

Developers, home builders, subcontractors, vendors and drywall manufacturers that have been sued for Chinese drywall-related claims likely will be looking to their general liability and professional liability carriers for coverage. Insurance companies already are balking. In what is believed to be the first of many disputes of this nature, Builders Mutual Insurance Company recently sued its insured, builder Dragas Management Corporation, in a federal declaratory relief action in Virginia. The insurer asserts that coverage for Chinese drywall claims is barred by the so-called "business risk" exclusions and/or a total pollution exclusion in its policies. *Builders Mutual Insurance Company v. Dragas Management Corporation, et al.*, No. 2:09-cv-185 (E.D. Va., filed Apr. 23, 2009). The insurer alleges that owners of Dragas-built homes where Chinese drywall was used have complained of "rotten egg smells in their houses, corrosion-related air conditioning failures, failures of televisions and microwaves, and health-related complaints including headaches, rashes, watery eyes, sinus congestion, apnea, coughing, sore throats and fatigue." The insurer acknowledges that these complaints likely all result from the "off-gassing" from the drywall of sulfur compounds, including carbon disulfide and carbonyl sulfide. The insurer contends, however, that it should not be liable to provide a defense or indemnification to Dragas based on the policies' "total pollution exclusion" as well as a "your work" exclusion, which bars coverage for damage arising out of the builder's work and related quality representations. According to the insurer, the pollution exclusion "unambiguously" excludes the Chinese drywall claims: "The off-gassing of the sulfur compounds from the Chinese drywall clearly constitutes the 'actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time,' and the compounds, which are known to be contaminants and irritants, clearly come within the definition of pollutants as 'any solid, liquid, gaseous, or thermal irritant or contaminant including smoke, vapor, soot, fumes, alkalis, chemicals and waste.'" In response, Dragas asserted counterclaims for breach of the implied covenant of good faith and fair dealing, and bad faith claims investigation.

Coverage for Chinese drywall claims almost certainly will generate disputes over numerous exclusions included in typical first-party and liability policies, including the pollution exclusion, the expected or intended exclusion, and the own-product, sistership, failure-to-perform, and impaired property exclusions.

One other important issue looms: recall. On March 30, 2009, two senators from Florida and Louisiana introduced a bill in the U.S. Senate, the Drywall Safety Act of 2009, which seeks to impose a recall of Chinese-made drywall and a temporary ban on imports until federal drywall safety standards are put in place to protect consumers. A companion bill has been introduced in the House. Such legislation, if passed, obviously will have a huge impact on the costs facing companies in the home construction industry in dealing with the Chinese drywall problem. It also will raise a host of insurance issues, as the law on coverage for recall-associated costs is complicated.

If you have any questions concerning this Client Alert, product liability or toxic tort claims, or insurance coverage issues, please contact your Proskauer relationship attorney or any of the attorneys listed below.

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