

Client Advisory

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Chinese Drywall Advisory No. 7

To our Friends and Clients:

We continue to monitor developments concerning the Chinese drywall crisis as this problem affects Florida residential and commercial property owners, insurers, and the construction industry as a whole. The landscape of this crisis continues to change as the results of scientific and medical studies are released, litigation continues, and interested parties such as property owners, insurers and the Federal government react to a myriad of emerging issues.

Litigation Update – Pollution Exclusion Invalidated

On March 22, 2010, Judge Lloyd Medley of the New Orleans Parish (Louisiana) Civil Court ruled in favor of insured-homeowners by holding that Policy exclusions for (1) gradual or sudden loss; (2) faulty, inadequate or defective planning; and (3) pollution do not apply to substandard building materials (i.e. Chinese drywall) under a homeowners insurance policy. *Finger v. Audubon Insurance Company*.

In striking the insurer's affirmative defense and finding that the pollution exclusion did not apply, Judge Medley noted that under Louisiana law (which is vastly different than Florida law, and the law of most U.S. jurisdictions), the insured's reasonable interpretation of what is covered under an insurance policy is a factor to be weighed in evaluating the coverage afforded under a policy. The Court further found that the pollution exclusion did not apply to a homeowner's Chinese drywall claims since, under Louisiana law, such exclusions are only intended to apply to "environmental damage", i.e. injury to a body of water, surrounding soil, etc., and specifically, do not apply to damage to personal property resulting from substandard building materials.

Judge Medley held that the "gradual or sudden loss" exclusion, which also typically applies to latent defects, did not apply because the clause was meant to protect the insurance company from wear and tear or gradual deterioration which is not the case with Chinese drywall. The insurer argued that the exclusion specifically referred to corrosion but Judge Medley rejected such assertion finding that the exclusion applies where corrosion is the cause of the property damage but not where corrosion is the damage itself. As to the "latent defect" aspect of the exclusion, Judge Medley held that there is no evidence that the Chinese drywall

was damaging or destroying itself, indicating the “inherent vice” or “latent defect” language in the exclusion.

With respect to the “faulty, inadequate or defective planning” exclusion, Judge Medley held that such exclusion did not apply because the Chinese drywall still effectively functions as drywall in a home i.e. it can be used to finish the interior of a home, hold paint and support hardware for hanging picture frames.

While Louisiana courts interpret a pollution incident under a “pollution exclusion” to be an incident which causes environmental or industrial damage *only*, Florida courts broadly interpret the standard pollution exclusion to include contact or interaction with contaminants, irritants, or pollutants of any kind, and to include both property and bodily injury claims occurring in any number of commercial, industrial, and residential settings. See *Deni Associates of Florida, Inc. v. State Farm Fire & Casualty Insurance Company*, 711 So.2d 1135 (Fla. 1998). In *Deni*, the Florida Supreme Court pointedly refused to adopt the approach of other courts, including Louisiana, which applied the pollution exclusion only to environmental or industrial pollution. *Deni* at 1138.

Scientific Studies

The U.S. Department of Housing and Urban Development and the U.S. Consumer Product Safety Commission (the “CPSC”) have just announced that they are now advising homeowners with Chinese drywall to completely remove the tainted product and replace all electrical components and wiring, gas service piping, fire suppression sprinkler systems, smoke alarms, and carbon monoxide alarms. Although this remediation protocol is being released prior to the completion of all ongoing scientific studies, the CPSC recommends these drastic measures as the best solution currently available to affected homeowners.

The CPSC has also released findings based on preliminary data from a study by Lawrence Berkeley National Laboratory (“Lawrence Berkeley”). Lawrence Berkeley measured chemical emissions from drywall samples obtained as part of the CPSC’s investigation and found that the top 10 reactive sulfur-emitting drywall samples were all produced in China. Certain samples had emission rates of hydrogen sulfide 100 times greater than non-Chinese drywall samples. Curiously, the study also noted that, for reasons unknown, several Chinese samples manufactured in 2009 demonstrate a marked *decrease* in sulfur emissions as compared to the 2005/2006 Chinese samples.

*For additional information or to discuss any of these issues,
please contact Jim Kaplan or Michael Sastre.*

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