

*Client Advisory*

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## Chinese Drywall Advisory No. 8

*To our Friends and Clients:*

Chinese Drywall activity never seems to slow down. As most of you already know, since our last report the first two Chinese Drywall verdicts were handed down by the Federal Court in Louisiana to the tune of \$2.6 million in the *Germano, et al. v. Taishan Gypsum, et al.* case and \$164,000 in *Hernandez v. Knanf*. The *Germano* case, which involved claims presented on behalf of seven (7) Virginia families, resulted in a judgment against one defendant only, Chinese Drywall manufacturer, Taishan Gypsum. Since Taishan did not timely respond to the complaint, a default was entered allowing the Plaintiff homeowners to put on an un-rebutted damages case. Since other defendants, including U.S. based suppliers, manufacturers, developers, and general contractors and most notably insurers were not included in the trial, or affected by this judgment, it is unclear what type of long-term impact this verdict will have. However, the *Hernandez v. Knauf Plasterboard Tianjin Co., Ltd.* verdict (decided last week), seems to be establishing a trend – notably, that the only viable remedy in the case of a home constructed using Chinese Drywall is to gut the home down to the studs. These Louisiana verdicts are already being described as “bellwether” cases in reporting around the country. In describing the *Hernandez* verdict, plaintiff’s counsel proclaimed that the judge had “sent an unequivocal signal to drywall manufacturers, suppliers, builders and others in the construction industry that they will be held responsible for total repairs caused by this horrendously inferior product”.

In other news, many in the industry found to be of great interest the distinction between Florida and Louisiana law in interpreting and applying standard pollution exclusion clauses. As we reported, Louisiana is very restrictive in its application of the exclusion, whereas Florida provides very broad application of the exclusion to residential, commercial, and industrial settings. It may not seem surprising then that on April 27, 2010 the Louisiana State Legislature passed a bill which would ban property insurers from dropping insurance coverage on buildings which contained Chinese Drywall. The bill, introduced by State Senator Julie Quinn, would prohibit property insurers from cancelling, refusing to renew, or increasing premiums or deductibles for businesses and homeowners as a result of their property containing Chinese Drywall. Any insurer found in violation of the law would be fined \$1,000 for each violation by the Louisiana Department of Insurance. So far, the bill has passed the State Senate unanimously and is expected to face little opposition in the House. In opposing the bill, the insurance industry argued that the law would invalidate many existing insurance contracts (which

contain contradictory policy terms re: cancellation and premium increases) and would cause rates to skyrocket across Louisiana. Although it is unclear at this time whether the bill will become law, it is noteworthy that no other state including Florida, has sought to introduce similar legislation.

Indeed, Florida appears to be taking a different approach to the crisis in asking the federal government for disaster relief assistance from the Federal Emergency Management Agency (FEMA). FEMA typically assists in cases of overwhelming natural disasters, as opposed to a consumer crisis involving defective products making the state's request unusual. Florida's Emergency Management Director, David Halstead, acting at the behest of Gov. Charlie Crist made the FEMA request March of this year. To the extent that FEMA decides to assist affected families, generally a cap of roughly \$30,000 per family would apply. When compared to builders' estimates of as much as \$100,000 per home to remediate defective drywall (by gutting the house down to the studs and replacing not only the drywall, but also any affected wiring or appliances), even FEMA assistance would be insufficient to pay for all the damage. According to the governor's request, 530 homes in Florida meet the Florida Department of Health guidelines for being affected by drywall reportedly fearing health risks from "unbearable noxious fumes".

One final item of interest that we report at this time involves the Louisiana Federal MDL Court's handling of an insurance declaratory judgment action which was initially filed in Florida, and then transferred to Georgia, before finally coming before the MDL for consideration. In that case, southeastern US homebuilder, the Mitchell Company, Inc. sued its insurer, Auto Owner's to obtain coverage for drywall claims asserted against the homebuilder. On April 5<sup>th</sup>, the Federal Court accepted jurisdiction on the insurance coverage case, notwithstanding the MDL's previous refusals to transfer similar declaratory judgment actions. Prior to the Auto Owner's case, the MDL panel had consistently held that coverage issues were not sufficiently related to the product liability actions so as to include them in the MDL. This time the objections from some of the insurers that coverage allegations should be evaluated based on the state law of each individual claimant insured failed to sway the court which found that the cases were sufficiently related for MDL purposes. Separately, Louisiana homeowner class actions have now been filed by residents against State Farm and Progressive insurance companies for damages caused by defective Chinese Drywall.

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

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