

*Client Advisory*

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## CHINESE DRYWALL UPDATE NO. 3

*To our Friends and Clients:*

As mentioned in our prior Advisories, heat and humidity catalyze and exacerbate harmful effects of Chinese drywall. Consequently, lawmakers fear that the Florida and Louisiana summers will reveal more affected homes and increase the gravity, scope and urgency of this crisis. Homeowners who cannot afford to relocate their families (in addition to paying their mortgage), will be forced to either stay in their homes and endure the purported deleterious health effects or seek alternative housing, default on their mortgages and risk foreclosure. In response, U.S. Reps. Robert Wexler (FL) and Mario Diaz-Balart (FL) sponsored and, on May 7, 2009 the House passed, an amendment to the Mortgage Reform and Anti-Predatory Lending Act, calling for departments of the federal government to study the effects of Chinese drywall on the mortgage foreclosure rate and the availability of property insurance for homes with Chinese drywall. Results are expected within 180 days.

The Consumer Product Safety Commission, (“CPSC”), which has been charged with responsibility for impounding and preventing the further importation of the defective drywall, has been accused of being slow to respond to this crisis. Claiming a lack of jurisdiction and funds to proceed with testing emissions from Chinese drywall, the U.S. House and Senate have each requested, and this month obtained, appropriations of \$2 million for the CPSC to proceed with testing drywall emissions.<sup>1</sup> In addition to this present influx of money, President Obama has increased the CPSC’s budget by 71% to \$107 million and replaced the Chair of the CPSC, Nancy Nord, after numerous Congressmen called on President Obama to fire Ms. Nord, who has been criticized for being too cozy with manufacturers.<sup>2</sup>

On May 19, the Environmental Protection Agency, (“EPA”), announced that the Chinese drywall contains the following compounds not found in U.S.-manufactured drywall: sulfur, strontium *at levels ten times higher than U.S.-made drywall*, and two organic compounds (propanoic acids) generally found in acrylic paint. At the first congressional hearing on Chinese drywall, occurring on May 21, the CPSC *confirmed* that these three compounds pose potential health threats. They further testified that their own scientists

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<sup>1</sup> As mentioned in prior Advisories, Florida’s Department of Health and some Florida home builders have already conducted such tests and found that the concentrations of emissions have been extremely low—insufficient to cause the reported symptoms.

<sup>2</sup> While Ms. Nord’s term does not expire until 2012 and she has not been asked to leave, President Obama also added two additional commissioners to the CPSC, making Nord the only Republican left on a five person commission.

who entered affected homes reported respiratory symptoms during testing and alleviation of same only when they left the homes. The CPSC also confirmed that the Chinese drywall is no longer being sold in the United States, and that there is more than one producer responsible for producing the defective drywall in China. While the CPSC did not identify the other Chinese manufacturers, commentators have consistently pointed to Knauf Plasterboard Tianjin, (“KPT”), a Chinese subsidiary of a German company, and Taishan Gypsum a/k/a Shandong Taihe Dongxin Co. Ltd., (“TG”), which was recently taken over by Beijing New Building Materials Group Co., a large Chinese building materials manufacturer owned by the Chinese government. Because TG is now owned by China, any attempts to recover from TG could involve negotiations with the Chinese government, which has a terrible track record of polluting the environment and allowing the exportation of defective and dangerous products. The CPSC has been working with the Chinese government and Sen. Bill Nelson (FL) has likewise urged President Obama to begin formal discussions with the Chinese government. Such high-level negotiations will be absolutely necessary given the difficulties traditionally associated with enforcing judgments against foreign manufacturers, particularly those tied to foreign governments.

To date, approximately 15,000 Floridians are plaintiffs in approximately 150 federal Chinese drywall lawsuits, at least 15 of which are class actions. Commentators estimate that as many as 75,000 Chinese drywall lawsuits could be filed nationwide sounding in tort, contract, warranty, insurance, etc. On May 27, 2009, the Judicial Panel on Multi District Litigation heard argument on a motion to consolidate all federal cases in one district. Defense and plaintiffs’ counsel alike urged that the cases be consolidated in the Middle District of Florida, Fort Myers Division, which has become the epicenter of the Chinese drywall crisis by virtue of the amount of affected homes in the region. Other districts under consideration are New Orleans and Miami. A decision is expected by mid-June.

Homeowners have begun suing insurers,<sup>3</sup> and insurers are, in turn, defending those cases based on Pollution Exclusions, which many commentators agree will provide a strong defense in Florida and other states.<sup>4</sup> However, insurers may also find succor from Chinese drywall claims in policies’ defective work exclusions.<sup>5</sup> Insurers may also preempt suits by insureds and seek a declaration from the court that the insured is responsible for the drywall damages.<sup>6</sup>

State officials worry that protracted litigation will be insufficient to address the more urgent problems faced by homeowners presently living in homes with tainted drywall and by homebuilders confronted with bankruptcy. Consequently, Florida State legislators have proposed but withdrawn before putting to a vote legislation to absolve

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<sup>3</sup> *Baker v. American Home Assurance Co., Inc.*, M.D. Fla., No. 09-cv-188-FtM—99DNF

<sup>4</sup> See *Deni Associates of Florida, Inc. v. State Farm Fire & Cas. Ins. Co.*, 711 So.2d 1135, 1137, n. 2 (Fla. 1998) (holding that pollution exclusions are unambiguous and enforceable against pollution related liability).

<sup>5</sup> E.g. Exclusions for Work Done by Subcontractors (CG2294)

<sup>6</sup> E.g. *Builders Mutual Insurance Co. v. The Dragas Co.*, E.D. Va., 2:2009-cv-00185

certain homebuilders, suppliers and contractors of liability for Chinese drywall. Florida Congressmen, however, continue to work with Governor Charlie Crist in developing a Chinese drywall task force to determine what new laws or regulations will be necessary to handle the more pressing aspects of the Chinese drywall crisis which protracted legal action may not adequately address.

The Chinese drywall litigation cottage industry that has developed overnight has already spawned a number of frauds in Florida. Prospective buyers of homes in foreclosure have been posting false notices on homes on the eve of foreclosure sale in the hopes of deterring competition at the auction. Other scams for testing and curing defective drywall have also cropped up, spurring Florida's Attorney General to issue a warning to homeowners to avoid scams involving solicitations for expensive testing for the presence of defective drywall and "miracle" applications to allegedly cure the problem.

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