

INSURANCE AND CONSTRUCTION INDUSTRY RELATED RAMIFICATIONS OF “CHINESE DRYWALL” CRISIS

To our Friends and Clients:

As many of you are aware, a litigation crisis is brewing involving the use of Chinese manufactured drywall in the construction of single-family homes in South Florida. The implications of this crisis are likely to be long term and widespread, affecting manufacturers, distributors, contractors, developers, real estate and insurance brokers, design professionals and insurers in the coming years. The problems appear to stem from the construction of single-family homes built between 2005 and 2007. Although the origin of the problem is still under investigation, early reports indicate that thousands of new homes constructed in South Florida during these years used drywall imported from China due to a scarcity of domestic made drywall.

A class action will be filed this week in Federal District Court in Miami, joining the pending cases (state and federal) in Florida and elsewhere. Last week the plaintiffs in one of those cases filed a petition before the Judicial Panel on Multi-District Litigation seeking to have all pending and subsequent cases transferred to the Southern District of Florida for coordinated treatment. Counsel for the putative class has indicated that the drywall problems also involve U.S. made drywall from USG and National Gypsum, two of the leaders in the industry.

One expert has stated that contrary to industry standards (providing that wallboard should be composed of 100% gypsum), some of the defective drywall is half gypsum and half cellulose. It appears that when cellulose combines with sulfate in moist, humid environments, it produces sulfurous acids which catalyze and further decompose cellulose, thereby releasing additional moisture resulting in further production of sulfurous acids in a continuing chain reaction. According to some experts, the effect of this process on any metals within the building system can be catastrophic. The sulfurous acids react with any metals in close proximity, typically electrical wiring, AC conduit and coils, and metal studs used to affix drywall, causing rapid degradation and aging of the metals. In one test, four (4) year old electrical wiring embedded in defective drywall had characteristics of forty (40) year old wiring.

Early assessments suggested that the affected drywall was most likely manufactured in China and distributed in the US by Knauf Tianjin, Taishin Gypsum and other manufacturers.

However, it now appears that U.S. manufacturers, such as National Gypsum and U.S. Gypsum, will also be implicated in the crisis.

If liability exists, the economic cure for this problem could be very expensive and time consuming since remediation may require gutting an entire home down to the studs. Moreover, the cost of re-wiring, or replacement of any air conditioning or electrical components, may also need to be factored into repairs. Potential health issues attributable to exposure remain unknown and undeveloped. However, many individuals living in affected homes have complained of allergy and respiratory type problems. The class action expected to be filed will seek damages for repairs, remediation, relocation, and inspections, as well as medical monitoring. The legal claims against the manufacturers are expected to include traditional claims of negligence, product liability, and breach of warranty, in addition to claims for unjust enrichment and violation of State and Federal laws prohibiting deceptive and unfair trade practices.

The ripple effect of the product liability litigation could be widespread. As is often the case in these types of claims, once the initial suits are filed against the manufacturers, third-party claims against contractors, subcontractors, suppliers, design professionals, real estate brokers and developers often follow. In addition to this anticipated second wave of litigation, claims against insurers are almost certain to follow on a myriad of policies including, CGL, Environmental, Builder's Risk, All Risk, E+O, Homeowners and Completed Products policies. Inevitably, this will require each particular insurer to evaluate not only their environmental exclusions and general provisions, but also their Vendor's and Additional Insured endorsements to see whether coverage may be impacted and extended to third parties in privity with the named insured.

Litigation will also focus on the terminology and clarity of exculpatory and indemnification clauses as well as any arbitration provisions contained in the construction contracts. Additionally, it is expected that the litigation will involve the "pre-suit notice" and "opportunity to repair" provisions found in Chapter 558, Florida Statutes. Under Chapter 558, Plaintiffs' contractors, subcontractors, suppliers, and design professionals are required to engage in alternative dispute resolution before a construction defect suit can be filed. Under this Florida law, the putative defendant must receive notice of the specific alleged defect and be given an opportunity to inspect the premises and determine the nature and cause of any alleged defect, as well as the extent of any repairs necessary to remedy the defect before offering monetary compensation or to remedy the defect or rejecting the claim.

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