

Hazardous Times[®]



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Will Imported Chinese Drywall Lead to a New Round of Construction Defects Litigation?

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Over the past few years, the news has been flush with information regarding hazardous imported products. Many of these hazardous

imports were manufactured in China. A wide array of Chinese-made products has been refused entry or has been the subject of product recalls and litigation including:

- > Toys painted with or containing high levels of lead
- > Counterfeit medicines such as the blood thinner Heparin
- > Seafood laden with banned antibiotics
- > Pet food containing melamine
- > Candy containing melamine
- > Toothpaste containing diethyleneglycol
- > Automobile and light truck tires prone to failure

Another defective product manufactured in China has recently come to light which will likely lead to additional construction defects and possibly toxic tort litigation against contractors and building material suppliers—Chinese-made drywall.

Imported Chinese-made drywall allegedly emits various gasses including carbon disulfide, carbonyl sulfide and hydrogen sulfide which creates odors and corrodes metals in heating, ventilation and air conditioning systems, pipes, wiring and even melted attic insulation. “Carbon disulfide and carbonyl sulfide can affect the nervous system and can be life threatening at very high levels, according to the U.S. Department of Health and Human Services’ Agency for Toxic Substances and Disease Registry and the U.S. Environmental Protection Agency. Low levels could cause headaches, tiredness and trouble sleeping.”¹

Allegations in one class action, filed in Florida, state that offgassing resulted

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when Chinese manufacturers incorporated fly ash, also known as waste material taken from scrubbers on coal-fired power plants, into the drywall.²

The Concern

Initially it was thought that the defective Chinese-manufactured drywall was installed in homes and condos as well as commercial buildings in Florida in 2006 when the repair of hurricane damaged buildings had created a shortage of U.S.-manufactured drywall. It now seems that the defective Chinese drywall was imported from 2004 through 2007, possibly 2008, and entered the U.S. through nearly two dozen ports including ports in California, Florida, Louisiana, Mississippi, New York, South Carolina and Washington, and may have even arrived in the U.S. market as early as 2001.³

Some 10 million square feet of drywall manufactured by just one Chinese manufacturer, Knauf Plasterboard (Tianjin) Co. Ltd, was used by Florida builders just between 2004 and 2006.⁴ This would equal about 200,000 sheets of drywall entering the Florida market in those years. We should note, however, that projects were likely built with drywall from as many as four sources, and according to one consumer protection group, “[As] few as three sheets of the defective drywall may be enough to contaminate a home to the point it may require bulldozing.”⁵

According to a construction consultant, who has been offering testing services to homeowners free of charge, between 30,000 and 60,000 homes in Florida alone eventually will

be identified as having a problem with the defective drywall.⁶ This estimate may be speculative given that as of February 28, 2009 the defective drywall has been found in some 800 Florida homes.⁷

The realty market has responded to the issue, and some Florida realtors have added questions about Chinese drywall to their disclosure statements when buying or selling homes.⁸

In early March 2009, the federal Consumer Product Safety Commission agreed to investigate complaints about the imported Chinese drywall.⁹ Two Florida legislators have asked other federal agencies to join in the investigation including the Environmental Protection Agency, Office of the U.S. Trade Representative and the Federal Trade Commission.¹⁰

Chinese drywall was also imported into Canada. It’s been reported that over 10 million square feet of Chinese drywall came through Vancouver between 2001 and 2006—all intended for the Canadian construction market.¹¹

Some of the builders that have allegedly used the Chinese-made drywall in Florida include Lennar Corp., Taylor Morrison, WCI, Meritage Homes, Ryland Homes, Transeastern and Standard Pacific. According to one plaintiffs’ attorney, building material suppliers that may have purchased the Chinese drywall include USG and L&W Supply.¹² The list of builders, subcontractors and building supply distributors is likely to increase as complaints and litigation spread both in Florida and across the nation.

COMPANIES IN THE NEWS...

Although not comprehensive, these companies have been mentioned in news articles as allegedly being involved with the distribution or installation of defective imported Chinese drywall. Some have already been named as defendants in drywall litigation.

U.S. Builders

- > Aubuchon Homes
- > Centerline Homes
- > EH/Transeastern LLC
- > Engle Homes
- > Lennar Homes
- > Meritage Homes
- > Ryland Homes
- > South Kendall Construction Corp.
- > Standard Pacific Homes
- > Taylor Morrison, f.k.a. Taylor Woodrow Communities, now a subsidiary of the UK’s Taylor Wimpey PLC
- > Touse Homes Inc
- > Transeastern and Standard Pacific
- > U.S. Home Corp.
- > WCI Communities

Subcontractors

- > All County Drywall Service Inc.
- > B&B Stucco Inc.
- > Bill Pfannkuch Framing Inc.

- > Distinctive Finishes
- > Florida Style Services Inc.
- > Harrell’s Drywall Inc.
- > J.D.M. Builders Inc.
- > MDW Drywall Inc., f.k.a. McCoy Drywall Inc.
- > Northeast Drywall Co.
- > Ocean Construction Inc.
- > Residential Drywall Inc.
- > S.D. & Associates Inc.

U.S. Building Supply Firms

- > Banner Supply Co.
- > Black Bear Supply Inc.
- > Independent Builders Supply Association Inc.
- > L&W Supply d.b.a. Seacoast Supply
- > La Suprema Enterprise Inc.
- > La Suprema Trading Inc.
- > National Gypsum
- > USG Corp.

Property Management Firms

- > Palm Isles Holdings LLC

Realty Firms

- > Keys Gate Realty Inc.

European Firms

- > Knauf Gips KG (Germany)
- > Taylor Wimpey PLC (UK)—has a Florida homebuilding subsidiary Taylor Morrison

Chinese Firms

- > Knauf Plasterboard (Wuhu)
- > Knauf Plasterboard (Dongguan)
- > Knauf Plasterboard (Tianjin)*
- > Rothchilt International (a China-based exporter)
- > Taishan Gypsum Co., f.k.a. Shandong Taihe Dongxin Co. Ltd.

* Knauf reportedly made about 20% of the plasterboard that was imported from China to the U.S. in 2006.

Litigation

Both class actions and individual lawsuits have already been filed on behalf of affected Florida property owners.¹³ Lawsuits have also reportedly been filed in Alabama by a home builder that has repaired damaged air conditioning units in some two dozen homes and class actions have also been filed in Louisiana and California.¹⁴

These lawsuits include allegations of both property damage and bodily injury. As mentioned earlier, property damage could be significant and in some cases may necessitate a complete rebuild. Allegations of physical ailments include respiratory problems, nosebleeds, headaches, nausea, itching skin, and allergy-type symptoms.¹⁵ Some lawsuits also seek damages for diminished property values and medical monitoring costs. Even realtors and property management firms have been named as defendants in Chinese drywall litigation.¹⁶

At least one builder, already named as a defendant in litigation filed by Florida property owners, has filed its own lawsuit against manufacturers and building supply distributors. Lennar Homes, the nation's second largest builder by volume, has filed a suit against several companies including German firm Knauf Gips KG and subsidiaries Knauf Plasterboard (Tianjin) Co. Ltd., and Taishan Gypsum Co. Ltd. The lawsuit also names eight building supply companies and a dozen subcontractors that installed the drywall.¹⁷

Another developer, WCI Communities, which allegedly filed for Chapter 11 bankruptcy protection last year, has reportedly established an \$11 million reserve for homes damaged by Chinese drywall. WCI has built communities in Florida, Connecticut, Maryland, New Jersey, New York, and Virginia. It's also been reported that just one subcontractor, Distinctive Finishes, handled 90% of WCI's drywall installation in Florida.¹⁸

While complaints about the drywall first appeared in Florida, it now appears, however, that the defective Chinese drywall has been installed in construction projects across the nation.

According to the Gypsum Association, some 300 million square feet of drywall was imported into the U.S. from China during 2006 and 2007. To put this in perspective, during that same period nearly 66 billion square feet of drywall was used in the U.S.¹⁹

Even though Chinese-made drywall equals only a small percentage of the total used in the U.S., it appears that litigation is about to spread beyond Florida. According to the consumer advocacy group America's Watchdog that has been tracking this issue, as of February 19, 2009, in addition to Florida, Chinese drywall had been found in homes and buildings in Alabama, Arizona, California, Georgia, Louisiana, Maryland, Michigan, Mississippi, Montana, Nevada, New Jersey, New Mexico, North Carolina, Oregon, South Carolina, Texas, Utah, Virginia, and Washington.²⁰ The group believes that some 250,000 to 300,000 homes and "low-rise" commercial properties nationwide may be affected—again an estimate that must be viewed as speculative at this point; however, the scope of this issue is just beginning to unfold.²¹

Defective Chinese drywall is not only a North American issue. Other countries likely imported drywall from China. It has already been reported that the defective drywall has been found in some Australian buildings.²²

In a telephone conversation with Thomas Martin from America's Watchdog, he said he is now aware of "thousands" of homeowners in 41 states that have lodged complaints about Chinese-made drywall. These complaints allege the drywall caused property damage, and many are also alleging exposure has caused adverse health effects. In March about a dozen homeowners from British Columbia, Canada contacted the consumer group reporting adverse health effects that they believe were caused by Chinese drywall.²³

While America's Watchdog believes this will be a national issue, the Atlanta office the federal Environmental Protection Agency is aware of only one case of property damage outside of Florida—in Virginia Beach, Virginia. Other sources, however, report that there have been additional "confirmed cases" in Alabama, Louisiana, Georgia and California as well with additional unconfirmed cases in North and South Carolina.²⁴

Some plaintiffs' attorneys and at least one environmental engineering firm allege that some American-made drywall is also releasing similar gasses and causing similar damage. American drywall manufacturers have denied this allegation.

Two issues make identifying the specific drywall manufacturer problematic: first, most drywall doesn't identify the manufacturer or its origin. Knauf's Chinese subsidiaries have stamped the company name on its exported drywall as required by law. It seems other Chinese manufacturers/exporters may not have complied with such laws.²⁵

Second, according to Mr. Martin, some of the Chinese-manufactured drywall came into the country—directly from China—stamped as "made in the USA" or "made in Canada" (i.e., counterfeits). In addition to sulfur gases being emitted by the drywall, he alleges that they have discovered small amounts of arsenic and radioactive materials. He suspects either may have come from nuclear or medical waste.

Mr. Martin said that testing performed for America's Watchdog shows that there is the potential for adverse health effects associated with exposure to this drywall. He also says that he has anecdotal evidence of contractors who installed Chinese-made drywall contracting serious illnesses. If this turns out to be true, Workers' Compensation carriers may be impacted.

Conclusion

At this point, it remains unclear as to how many buildings nationwide will be affected. There are no standard procedures for remediating buildings that contain defective Chinese drywall, and actions taken to address the issue vary by contractor. One affected developer has been rebuilding the entire inside of homes replacing everything except the exterior structure and framing—even stripping out carpeting and insulation. These rebuilds are taking between three and six months to complete.²⁶ If this approach gains acceptance, claims costs could be considerable.

According to one plaintiffs' attorney, many of the affected Florida homes are valued between \$300,000 and \$500,000. The attorney estimates that "it will cost the plaintiff one-third of the value of his or her home, plus relocation expenses and the expense of repairing personal property such as TVs, refrigerators and audio equipment."²⁷

Even rebuilding the entire inside of homes may not be enough in some cases. There have been reports of rust and oxidation on metal framing components including galvanized nails and truss supports placing the structural integrity of these building in question.²⁸

Litigation is spreading. Originally, lawsuits were filed only on behalf of Florida property owners. Now litigation has also been filed in Alabama, California, Louisiana and South Carolina.²⁹ Given that injured parties have little to no legal recourse against Chinese manufacturers or China-based exporters, U.S. building supply distributors, builders, and drywall

subcontractors may become the primary defendants in any construction defects or toxic tort litigation arising from Chinese drywall. As we have seen with other construction defect scenarios, this may become a significant issue for insurers providing CGL and/or Commercial Umbrella coverage for these classes of businesses.

One additional thought for insurers providing CGL and Commercial Umbrella coverage for builders and contractors. Even if new/future projects use drywall that is not imported or defective, will insurers see claims because they insure a contractor whose previously installed defective Chinese drywall is still causing damage today and because it's not yet discovered, triggers a loss on their current policy? The answer is heavily dependent upon jurisdiction. Coverage actions have resulted in a patchwork of rulings by various states regarding the appropriate trigger of coverage in construction defect claims. ■

Endnotes

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