

## construction litigation bulletin

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### Chinese drywall – construction products claims and coverage issues

The words “Chinese drywall” may at the moment mean very little to Canadian manufacturers, contractors, suppliers and home builders. Law suits along the southern and eastern coast of the United States arising out of the use of defective drywall, manufactured in China and installed in thousands of homes, has not spread to Canada. Yet those in the construction industry would be well advised to stay alert to recent legal developments.

Imported into the US in the last ten years, Chinese drywall was used to redress shortages caused by the mid-decade housing boom and the rebuilding of hurricane torn communities. The US International Trade Commission data reveals that approximately 518 million pounds of Chinese drywall entered the country between 2004 and 2008.<sup>1</sup>

Shortly after the installation of Chinese drywall homeowners began to complain of noxious, “rotten egg” smells. New homes also experienced failures of HVAC systems and other appliances, blackening of copper electrical wiring and household metals.

By 2006-2007 consumer watchdog groups and government agencies were receiving mass complaints of injuries to both property and person. In 2008, investigations carried out by the Environmental Protection Agency and the Consumer Product Safety Commission confirmed that that the product was emitting sulphur gasses. More than 7000 people filed complaints over defective drywall. It is estimated that between 36,000 and 100,000 homes in the US may contain the material.<sup>2</sup>

The legal consequences of these developments are, in part, being determined in multidistrict litigation in Louisiana.

<sup>1</sup> “Chinese Drywall: Background, Scope and Insurance Coverage Implications – Part 1” *The Free Library* (16 September 2009), online: The Free Library <http://www.thefreelibrary.com/Chinese+Drywall:+Background,+Scope+And+Insurance+Coverage+...-a0212799551>.

<sup>2</sup> *Ibid.*; Chinesedrywall.com, online: <http://www.chinesedrywall.com/>.

## the U.S. litigation

The first two decisions in this multidistrict litigation process were handed down in April by Judge Fallon of the Eastern District of Louisiana. Among other things, the decisions sets out the scope of remediation required of defendant manufacturers of Chinese drywall.

The first of the two cases involved a class action suit by seven Virginia families against Chinese manufacturer Taishan Gypsum Co.<sup>3</sup> In the course of its ruling, the court accepted that the plaintiffs' homes had been exposed to high levels of corrosive gases and that "this condition is clearly irritating and harmful to residents and destructive to property."<sup>4</sup>

The court ordered extensive remediation which included the replacement of all drywall, wiring, plumbing, flooring, and any other materials that may have absorbed gasses. The defendant was also responsible for the cleaning and airing out of houses, along with the post-clean up environmental certification.

The court also found that the plaintiffs could recover for the loss of personal property – e.g., carpets, curtains, and clothing. Economic damages arising from the loss of use and enjoyment of home, alternative living costs, costs associated with foreclosures, bankruptcies and the reduction of property values were also awarded.<sup>5</sup> Total damages for the seven families amounted to \$2.6 million.

Taishan did not participate in the initial litigation, but has since hired US attorneys and filed an appeal to the decision.

In the second case, the court awarded \$164,000 total damages on a single home against the defendant Knauf Plasterboard Tianjin Co., Ltd. for remediation and damages to personal property.<sup>6</sup> Prior to the hearings, Knauf had agreed that the drywall in the plaintiffs' home was defective and not fit for use, but Knauf contested the scope of remediation demanded by the plaintiffs. The parties agreed that all drywall (whether Chinese or domestic), all insulation, flexible duct work, switches, receptacles, molding and countertops had to be completely removed and replaced. There was disagreement as to whether the electrical, plumbing, and HVAC systems, and various other items required removal and replacement. The court found in favour of the plaintiffs.

Litigation within and outside the multidistrict process continues in the United States.<sup>7</sup>

<sup>3</sup> *Germano v. Taishan Gypsum Co., Ltd.*, 2010 WL 144564 (E.D. La. 2010).

<sup>4</sup> *Ibid.*, at 12.

<sup>5</sup> *Ibid.*, at 30-33.

<sup>6</sup> *Hernandez v. Knauf Gips KG, et al.*, 2010 WL 17043 (E.D. La. 2010).

<sup>7</sup> Aaron Kessler, "Chinese Drywall Maker Settles Federal Case" *Herald-Tribune* (18 June 2010), online: Herald-Tribune <http://www.heraldtribune.com/article/20100618/BREAKING/100619689/2055/NEWS?p=1&tc=pg>.

## insurance claim issues

Whether commercial general liability (CGL) policies will provide coverage to manufacturers and suppliers is dependent on the interpretation and applicability of two common exclusions - Own Product and Pollution Exclusions.

The “own product” exclusion is standard in most CGL policies and does not allow an insured to claim the costs of repairing or replacing the insured’s defective product.<sup>8</sup> However, the cost of repairing or replacing a product damaged by factors other than a product defect is not part of the exclusion. Based on the current state of the law in Canada, the removal and replacement of the drywall itself is likely excluded by the terms of most CGL policies. The cost of replacing all other elements affected by drywall most likely falls within the scope of coverage.<sup>9</sup> US decisions on this point are in conflict.<sup>10</sup>

Another relevant CGL policy exclusion bars coverage for damage resulting from pollution. Cases in Canada and the United States are divided on what qualifies as pollution and specifically whether this excludes coverage for damages resulting from indoor pollution due to routine commercial hazards.<sup>11</sup> So far US courts dealing with this exclusion have split on whether sulphur emitting drywall can be characterized as pollution.<sup>12</sup>

While insurance cases dealing with Chinese drywall are still before the courts, a recent decision by a Virginia court is particularly relevant for those confronted by consumers seeking remediation.<sup>13</sup> The case involved a homebuilding company that, on its own initiative, chose to remove and replace Chinese drywall installed in homes by one of its subcontractors to manage potential litigation. Interestingly, the court ruled that the insurer in that case was not required to cover the cost of the remediation because the insured’s remediation was agreed to before it faced an actual legal obligation to do anything. By agreeing to remediate, the insured had acted in a manner which increased its exposure contrary to its obligations under its Policy. Moreover, the insurer had not been consulted with or consented to the remediation.

## lessons for Canada?

The concern over Chinese drywall has not steered completely clear of Canada. Since the spring of 2009 there have been rumblings about the use of Chinese drywall in

<sup>8</sup> See, for example, *Alie v. Bertrand & Frère Construction Co.* (2002), 62 O.R. (3d) 345 (C.A.). The scope of the exclusion is determined by the definition in the policy and the circumstances under which a claim is made.

<sup>9</sup> *Ibid.*, at para. 319.

<sup>10</sup> *Finger and Rebecca Finger v. Audubon Insurance Company*, 2010 WL 1222273 (Civ. D. La. 2010); *Travco Insurance Company v. Ward*, 2010 WL 2222255 (E.D. Va. 2010).

<sup>11</sup> *Zurich Insurance Co. v. 686234 Ontario Ltd.* [2003] I.L.R. 1-4137, 166 O.A.C. 233, 222 D.L.R. (4th) 655, 43 C.C.L.I. (3d) 174, 62 O.R. (3d) 447.

<sup>12</sup> *Supra*, note 10.

<sup>13</sup> *Builders Mutual Insurance Company v. Dragas Management Corporation*, 2010 WL 1257298 (E.D. Va. 2010).

a number of Canadian communities, mostly in the Lower Mainland area of British Columbia. A US consumer watchdog group claims to have received about 500 calls from concerned BC and Alberta residents since the news of the US law suits spread north.<sup>14</sup> Statements in the media suggest that one million square metres of Chinese drywall arrived in Canada through Vancouver between 2001 and 2007.<sup>15</sup>

While most of the drywall used in Canada is produced domestically, the Canada Border Services Agency (CBCA) recently stated that two Canadian companies imported drywall made by Taishan, the defendant in the first U.S. case. Although, recent reports from building industry officials suggest that tainted Chinese drywall has not been used in Canada.<sup>16</sup>

If Chinese drywall does eventually become the subject of dispute in Canada, Canadian courts and regulatory agencies will no doubt turn their attention to the judicial statements of US courts and any standards set out for drywall clean-up by US government agencies. Moreover, Canadian courts will likely take cues from the MDL litigation when dealing with broad and complex claims for alleged defective building products.

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<sup>14</sup> Richard Gilbert, "The elusive tale of toxic drywall from China" *Journal of Commerce* (29 April 2009), online: *Journal of Commerce* <http://www.journalofcommerce.com/article/id33586/gtcontracting>; Also see Joan Delaney, "Building Industry Officials Say No Sign of Tainted Chinese Drywall in Canada" *The Epoch Times* (26 May 2010), online: *The Epoch Times* <http://www.theepochtimes.com/n2/content/view/15781>.

<sup>15</sup> Bob Aaron, "Chinese drywall creating crisis" *The Star* (20 June 2009), online: Aaron & Aaron Barristers and Solicitors <http://www.aaron.ca/columns/2009-06-20.htm>.

<sup>16</sup> *Supra*, note 14.

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#### a cautionary note

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