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Construction Practices News Alert, April 2010

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## FIRST CHINESE DRYWALL VERDICT A BIG ONE SHOT ACROSS THE BOW OR HARBINGER OF THINGS TO COME?

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In the first Chinese drywall verdict to come out of the Multidistrict Litigation (MDL) venued in Federal Court in New Orleans, Judge Eldon Fallon awarded \$2.6 million in damages in an April 8, 2010 ruling in a non-jury trial involving the claims of seven homeowners in Virginia. The damages were awarded to the owners as the cost of remediating their homes. The verdict is against a Chinese manufacturer, Taishan Gypsum, only, however, and collecting on the judgment will prove difficult. China is not a signatory to the Hague Convention on Execution of Foreign Judgments which is an international treaty that would have facilitated collection on the award in China. But before you start wagging your finger toward Asia, note that the United States is also not a signatory so a judgment in China would theoretically not be enforceable in the United States, either.

Drywall was imported into the United States from China from 2004 – 2006 to meet demand caused by the building boom from 2000 – 2005 and repairs necessitated by Hurricanes Ivan and Jeanne in 2004, and Dennis, Katrina and Rita in 2005. Homeowners in 41 states suspect that they have drywall from China in their homes, with the largest concentration in Florida, followed by Louisiana, California, Mississippi, Texas, South Carolina, North Carolina, New York, Georgia, Washington, Pennsylvania, New Jersey and Virginia.

Extrapolating from the amount of Chinese drywall imported, it is estimated that 60,000 to 100,000 homes could be affected. Given the court's ruling that the cost of properly remediating just seven homes is \$2.6 million, then the cost of remediating all of the affected homes could reach \$40 billion or more.

While this verdict was essentially the result of an unopposed assessment of damages hearing against a defaulted and absent defendant, Judge Fallon allowed all "interested parties" in all cases in the MDL to participate in the evidentiary hearing "to address the scope and extent of appropriate remediation, and the cost of remediation." *Opinion at page 5.* There were seven plaintiff intervenors - essentially, seven plaintiff guinea pigs looking to see

what they would be awarded. Presumably, these homes were very carefully chosen by the plaintiff MDL committee. On the defense, Knauff Plasterboard Tianjin Co. Ltd. and The Mitchell Company intervened. Knauff is a German company that owns many of the Chinese drywall manufacturers. Mitchell is a large southeast United States builder developer facing many of these claims. Both Knauff and Mitchell withdrew on the eve of the hearing leaving the proceedings unopposed. The opinion does not offer any insight as to why Knauff and Mitchell withdrew, but it could be that they felt "the writing was on the wall" and they wanted to be able to argue in later proceedings that Judge Fallon's rulings were not binding on them. However, because intervenors in the MDL were invited, and especially because these two opted in and then only later opted out, the argument that these findings are not binding will be difficult. The actual hearing took place in February and lasted only four days.

While some parts of this ruling might not be binding on all the other cases from all the other jurisdictions where Chinese drywall cases have been filed that are now in the MDL, many findings will be binding - at least Judge Fallon will so hold and it will be up to the defendants on appeal to see if they can reverse that. The findings that are likely to be held to be binding are:

- Chinese drywall has a significantly higher average concentration of strontium and significantly more detectable levels of elemental sulfur.
- Chinese drywall releases reduced sulfur gases. The three main gases that are released from the drywall are hydrogen sulfide (H<sub>2</sub>S), carbonyl sulfide (COS), and carbon disulfide (CS<sub>2</sub>). The CDW also releases elemental sulfur.
- The sulfur gases released by Chinese drywall are irritating to the human body. Exposed individuals reported irritation of the eyes, respiratory system, and skin, among other things.
- The sulfur gases released by Chinese drywall cause offensive odors in homes, making them hard if not impossible to live in.

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- The sulfur gases released by Chinese drywall are corrosive to metals, particularly copper and silver. Copper and silver metal components in the Plaintiffs' houses are extremely vulnerable to corrosion from exposure to the sulfur gases.
- The corrosion on metals caused by the sulfur gases emitted by Chinese drywall causes premature failure of electrical and mechanical devices.
- The corrosion on metals caused by the sulfur gases emitted by Chinese drywall poses a fire risk.

*See Opinion pages 12 - 17.*

The following findings will also likely be held to be binding, but can be somewhat fact sensitive from home to home. Defendants will definitely fight these following findings on a case by case basis:

- All Drywall in the Plaintiff-intervenor Homes Needs to be Removed and Replaced
- All Electrical Wires in the Plaintiff-intervenor Homes Need to be Replaced
- All Copper Pipes in the Plaintiff-intervenor Homes Need to be Replaced
- HVAC Units in the Plaintiff-intervenor Homes Need to be Replaced
- Selective Electrical Devices and Appliances in the Plaintiff-intervenor Homes Need to be Replaced
- Some Flooring Needs to be Replaced; Carpet Must be Replaced; Hardwood or Vinyl Flooring Must be Replaced; Tile Flooring May Need to be Replaced
- Items Which Must be Removed With the Drywall May Need to be Replaced, such as Cabinets, Countertops, Trim, Crown Molding and Baseboards, Bathroom Fixtures
- Insulation Must be Replaced
- The Plaintiff-intervenor Homes Will Need to be Cleaned with a HEPA Vacuum, Wet-wiped or Power-washed, & Allowed to Air-out After Remediation
- After Remediation, an Independent, Qualified Engineering Company Should Certify that the Homes are Safe for Occupation
- The Scope of Work is Consistent with Chinese Drywall Remediation by National Homebuilders
- The Court's Scope of Remediation as Compared to the NAHB & CPSC Remediation Protocols
- The Plaintiff-intervenor Families Will be out of Their Homes for 4-6 Months During Remediation

*See table of contents of opinion and the sections referenced therein.*

So if there was any question as to how remediation of only seven homes would cost \$2.6 million, this should answer that question. It may literally be the case that it would be less costly to demolish the entire home and rebuild it. Remediations this extensive often exceed replacement cost of the home and builders found liable or sometimes as the result of a negotiated settlement, buy back the home and either remediate it on their own terms or simply demolish it, rebuild and resell.

In the coming days and weeks, there will be intense maneuvering regarding where to draw the battle lines. Judge Fallon's ruling establishes some incredibly high stakes and portends the ruination of builders, subcontractors and domestic sellers of Chinese Drywall unless the courts declare that their general liability insurance policies cover these claims. However, while that may save the builders, subcontractors and domestic sellers, it would be an enormous blow to the insurance industry that paid to repair hurricane damaged homes once already, but now because of the use of contaminated drywall from China, they may have to pay to repair them all over again.

This is hardly the kind of news that either the residential construction industry or the insurance industry needed at this point in time. And the battle between insureds and insurers over whether these claims are covered or excluded by the pollution exclusion found in most general liability insurance policies, or otherwise, will now escalate dramatically with these kind of stakes involved.

On the insurance coverage front, there still are no definitive decisions in the many coverage suits that have been filed. A recent state trial court ruling, which has been heavily discussed online in claims and construction blogs, held that the pollution exclusion in a homeowner's policy (among other exclusions) did not apply to claims arising out of Chinese drywall. *See Finger v. Audubon Insurance Co.*, Docket No. 09-8071 (New Orleans Parish Civil District Court, Louisiana, March 22, 2010). Coverage issues abound in the Chinese drywall litigation and will be addressed in an upcoming issue.

In other interesting developments, a motion is now pending before the Judicial Panel on Multidistrict Litigation to create a federal consolidation under the MDL rules for claims involving defective American drywall. It is still unclear whether the hydrogen sulfide off-gassing attributed to American drywall is because the American drywall was made in China and rebranded and remarked as American or whether the gypsum in the product came from China and the drywall was made in the United States or perhaps the gypsum really came from American mines and really contains the contaminants that cause the chemical reaction under high heat and humidity to generate highly corrosive hydrogen sulfide gas. But the copper wiring, pipes and HVAC coils in these homes don't seem to care what the "Made in" label says and the copper is failing, anyway.

One of the goals of the plaintiffs in the American drywall litigation is

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to take the necessary discovery to find out where the gypsum for the drywall was ultimately mined. But the product liability law of most states would make it so that for the homeowners, the ultimate origin of the drywall is irrelevant to the homeowner trying to recover. If sold by an American company and if defective, the American company can be held liable and then it would be up to the American company to collect on theories of indemnity and primary/secondary liability from any alleged Chinese mining company that supplied the gypsum.

The \$2.6 million verdict in New Orleans will certainly be a wake-up call to the Chinese manufacturers and signals to them loud and clear that if they continue to ignore this litigation and fail to have counsel enter and defend or, more appropriately, mediate and “face the music,” they will eventually face a potential \$40 billion U.S. debt. There will be enormous pressure placed on the United States government to do something about this issue. There are already bills introduced in Congress to require Chinese companies, generally, exporting to the United States to provide financial responsibility for their products so that a remedy can exist for victims of any products found to be defective and that cause harm.

America is a critical market for the Chinese and for that market to remain open, it is also thought by many that the Chinese manufacturers and/or Chinese government will have to offer a substantial monetary contribution to the remediation costs of the 100,000 plus or minus homes that are losing their wiring, plumbing and HVAC systems to corrosion from hydrogen sulfide gas from contaminated drywall.

The ultimate resolution to the Chinese drywall litigation may be in Congress instead of the courts. Although if there is anyone out there that can figure out how to execute on a U.S. judgment in China, that may also be the silver bullet homeowners and their builders and insurers need. White and Williams LLP has a nationally recognized Construction Defect team that handles significant construction defect litigation coast to coast, east to west and north to south. We also have a China Business Practice Group that has had success in representing entities in U.S.-China disputes, both in the U.S. and in China. This unique collection of talent positions us well to defend American builder/developers, contractors, subcontractors and suppliers and also pursue reimbursement from Chinese manufacturers on their behalf as well as on behalf of their insurers.

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