

[Alerts and Updates]

The Walls Are Closing In: Chinese Drywall Issues Prompt Legislation and Litigation

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Certain drywall manufactured in China is allegedly defective. It has been alleged that this defective drywall corrodes electrical wires and copper coils, and emits "rotten egg" fumes that cause respiratory health problems. It is estimated that 60,000 residential houses in the southeastern United States have been built using this purportedly defective drywall. As a result, the U.S. Congress has responded with new legislation, and litigation has been increasing.

Legislation

Recent legislation directs the U.S. Department of Housing and Urban Development ("HUD"), the U.S. Consumer Product Safety Commission ("CPSC"), the National Institute of Standards and Technology ("NIST") and the U.S. Environmental Protection Agency ("EPA") to address the wide-ranging impact of the Chinese drywall situation.

Amendment to Mortgage Reform Act: The U.S. House of Representatives recently passed a measure, H. Amdt. 118, that calls for HUD to study:

- The availability of property insurance for residential structures with Chinese drywall and
- The effects of the presence of Chinese drywall on residential mortgage foreclosures.

This measure is an amendment to the Mortgage Reform and Anti-Predatory Lending Act, H.R. 1728.

Drywall Safety Act of 2009: Both the U.S. Senate and the House of Representatives recently introduced identical bills to address the allegedly defective drywall imported from China between 2004 and 2007. The bill, H.R. 1977, has been referred to the House of Representatives' Energy and Commerce Committee. The bill, if enacted, would require the following actions:

- **Product Study:** The CPSC (with the NIST and the EPA) has 120 days to study "the material and chemical composition" of drywall that was imported from China between 2004 and 2007 and used in U.S. houses. The study will analyze: (a) the chemical and organic composition of drywall samples, (b) the effect of such compounds or emissions emanating on metal fixtures commonly found in residences, and (c) any health or environmental impact from exposure. The results of such a study are likely to play an important role in any litigation regarding Chinese drywall.
- **Product Safety Standards:**

The CPSC has 180 days to determine whether to enact a consumer-product safety standard regulating the composition of materials used in drywall "to protect the health and safety of residential homeowners." The standard focuses on residential use; however, the standards are also likely to impact commercial use.

- **Temporary Ban:** Within 30 days of the enactment of the bill, the CPSC will impose a temporary ban on drywall exceeding 5-percent organic compounds, by weight, as being defective. An order would then be issued to manufacturers,

distributors and retailers of this drywall. The ban would be effective until the CPSC publishes a determination that a consumer-product safety standard regulating the composition of materials used in drywall is no longer necessary.

Litigation

As previously reported in "[The Writing Is on the Wall': Defective Drywall Claims Prompt More Legal Action](#)," which appeared in the Spring 2009 *Building & Bonding: The Construction Group Newsletter*, litigation has commenced against the product manufacturers and the distribution chain. However, additional areas of litigation are emerging, including the following:

Foreclosure: Some homeowners have stopped paying their mortgages, claiming that they should not have to pay for allegedly defective homes that cannot currently be sold or inhabited. These claims are especially common in Florida, as a result of recent and substantial decreases in real estate values. Such defaults by homeowners will likely result in foreclosure proceedings. Lenders who have foreclosed on these homes may have to explore their remedies against other potentially responsible parties, as simply selling the foreclosed houses will be difficult or impossible.

Insurance Coverage: Issues exist regarding whether the drywall-related claims are covered by certain insurance policies. For example, areas of contention may arise as to whether the claim is subject to an exclusion, such as: (a) the pollution exclusion, because there are allegations that the damage is caused by gases emitted from the drywall; (b) "your work, your product" exclusion; or (c) mold exclusions that are usually included in coastal areas. Regarding third-party property damage or construction-defect claims, a key issue concerns whether a claim for faulty workmanship leads to an occurrence under a general liability policy. Also, disputes regarding the "trigger of coverage" are likely to arise between first-party policies. Finally, this exposure may create not only areas of contention but also new opportunities for insurers. Underwriting opportunities for specialty insurers may develop from recently formed businesses that are inspecting homes for the presence of Chinese drywall and to remediate damage.

The legal issues regarding "Chinese drywall" are impacting many business sectors—manufacturers, construction, insurance, real estate, home associations, mortgages, foreclosures and healthcare. We will continue to monitor the development of legislation and litigation.

For Further Information

If you have any questions regarding this topic or would like more information, please contact [Sheila Raftery Wiggins](#), any [member](#) of the [Construction Group](#) or the attorney in the firm with whom you are regularly in contact.