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## **CHINESE DRYWALL: THE NEXT WAVE OF CLAIMS?**

### **Richards Buell Sutton Insurance Law Newsletter**

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Just when the peak of “leaky building” claims has worked its way through the legal system, now comes word that the next wave may be coming in the form of toxic Chinese drywall. While Chinese drywall claims are surfacing in the Gulf Coast region of the United States (which experienced a home building boom in the aftermath of a series of devastating hurricanes), recent reports suggest the same product was imported into Canada, and used in the lower mainland of British Columbia.

#### **Background**

Drywall produced in China and imported to Canada and the United States from 2001 to 2007 is being linked to toxic gases which are alleged to cause property damage and a variety of health symptoms such as nose bleeds, respiratory problems, headaches, nausea and skin irritations. Early studies suggest that a sulfur compound is emitted from the drywall, causing health effects and corroding of electrical wiring, HVAC components and even household appliances.

Thousands of lawsuits have been filed in the south eastern United States against manufacturers, distributors and home builders for the production, sale and use of Chinese drywall. Insureds are seeking coverage under liability policies for third party claims being brought against them and it is expected that first party claims by homeowners won't be far behind.

#### **Third Party Issues**

Similar to the epidemic of leaky building lawsuits, defective Chinese drywall will give rise to lawsuits against developers, contractors, subtrades and material suppliers for claims involving “bodily injury” and “property damage”. Commercial General Liability (“CGL”) policies provide broad coverage for bodily injury claims brought by third parties against an insured. In the context of Chinese drywall cases, CGL insurers can expect to be faced with defending lawsuits brought against an insured for bodily injury arising from the exposure to noxious gases emitted by the drywall.

CGL policies also provide coverage for property damage that results from an “occurrence”. An “occurrence”





is typically defined as an accident, which includes continuous or repeated exposure to substantially the same general harmful conditions. In Canada, the case law differs from one province to the next as to what constitutes an “occurrence” in the construction defect context. In British Columbia, there is case law to suggest that a construction defect can never be an “occurrence” because it lacks the element of fortuity. In Ontario, however, while the damaged work itself may not be covered, the damage that results from that defective work is considered an “occurrence”. Generally speaking, the purpose of coverage under a CGL policy doesn’t extend to the risk of repairing or replacing the insured’s own defective work.

In the same manner that water ingress damage took time to surface in the leaky building cases, it may take time for property damage to surface in the context of Chinese drywall claims. That gives rise to a problem: when is coverage triggered for construction defects under a CGL policy? Is it when the drywall was first installed, or when the homeowner first began to notice the damage or corrosion, or is it simply a continuous trigger so that all CGL policies that were in effect while the damage was “ongoing” are triggered? Few of the leaky building cases have actual evidence of when the damage occurred. As a result, every CGL carrier who provided insurance to a developer, contractor, subtrade or material supplier between the date of substantial completion of the construction project, and the date the claim is made or the damage is repaired, has been involved in these types of claims.

If an insured can establish an “occurrence” to trigger coverage for a third party claim under a CGL policy, what standard CGL policy exclusions might bar coverage in Chinese drywall cases? Some of the standard exclusions which could potentially apply to exclude coverage are the pollution exclusion, the “fungi, mold and bacteria” exclusion, the exclusion for injuries “expected or intended”, and the exclusions for faulty workmanship, defective design, contractual liability, your work, the insured’s work product, premises owned, and impaired property.

### **First Party Issues**

The first issue in the coverage analysis under a homeowners insurance policy, for damage to a home caused by defective drywall, is whether the damage constitutes “direct physical loss” to property. The insuring agreement under most homeowners insurance policies insures against the “risk of direct physical loss to property”, subject to various coverage exclusions. Whether or not construction defects related to the use of poor quality materials constitute “direct physical loss to property”, remains to be seen.

If a homeowner can overcome the threshold issue of proving “direct physical loss”, most homeowners’ insurance policies contain exclusions which could restrict or eliminate coverage altogether. For instance, a claim involving the emission of hazardous gases from the drywall may fall within the scope of a standard





homeowners pollution/contamination exclusion. Water damage exclusions may also apply because many of the hazardous aspects of Chinese drywall arise when it is exposed to water or humidity. Many homeowner policies also contain a standard “inherent vice” exclusion for damage caused by “mechanical breakdown, latent defect, inherent vice, or any quality in property that causes it to damage or destroy itself”.

### **Practical Considerations For Insurers**

Is it too late for insurers to introduce a new exclusion for property damage caused by Chinese drywall? While an insurer cannot protect itself against the portion of damage that has already occurred, it is not too late to introduce new wording to exclude this type of damage going forward. In the same way that many CGL insurers introduced “water ingress” exclusions to their liability policies after leaky building cases began to surface, insurers should consider introducing a “Chinese drywall” exclusion to limit risk before such claims become ubiquitous.

Insurers would also be well advised to remain vigilant as to their exposures for toxic Chinese drywall in British Columbia. While the British Columbia Wall and Ceiling Association denies that Chinese drywall was widely used in British Columbia, it acknowledges that 929,000 square metres of board landed in Vancouver between 2004 and 2007 and that “rogue” contractors may have used the product. The fact that no, or very few, actions have been commenced in superior court is a positive sign that British Columbians may not suffer extensive damage from Chinese drywall, but, given the potential for huge exposures and the “long tail” nature of these claims, the final chapter is far from being written.

