

RAMIFICATION OF CHINESE DRYWALL DEFECT CLAIMS ON HOMEBUILDERS AND DEVELOPERS

**By: Peter K. Spillis, Esq. and Steven D. Gonzalez, Esq.
Weinberg, Wheeler, Hudgins, Gunn & Dial, LLC**

April 14, 2009

I. Introduction

Throughout the southeastern United States, and particularly in Florida, numerous class action lawsuits have begun to be filed seeking damages for allegedly defective Chinese drywall. This paper outlines the history and scope of the Chinese drywall issue, discusses the liability considerations for homebuilders and developers, as well as their potential remedies, and sets forth a recommended course of action for those homebuilders and developers.

II. History

Between 2004 and 2006, the major housing boom in the southeastern United States, compounded by massive damage caused by Hurricanes Katrina and Wilma in 2005, led to a shortage of construction materials in the United States. This left domestic builders and suppliers looking for a secondary source of drywall. China became that secondary source. Numerous lawsuits filed to date are focusing on a particular German manufacturer with plants in China named Knauf Gips KG. Knauf maintains three major drywall manufacturing plants in three separate provinces in China and is alleged to have imported millions of pounds of drywall into the United States; However, it is believed that this product also entered the country through other manufacturers and suppliers.

It is estimated that between 2004 and 2006, more than 600,000,000 pounds of drywall was imported to the United States from China – enough to construct 60,000 to 100,000 average sized homes. Port records show that over 100,000,000 pounds of this drywall was imported through the Port of Miami, 80,000,000 pounds through Port Everglades and 50,000,000 pounds through the Port of Tampa. Additional large quantities were received through other ports in Florida and up the Eastern Seaboard.

Drywall, which is also commonly known as gypsum board, wallboard, plasterboard, rocklath, sheetrock or gyproc, is made of a paper liner wrapped around an inner core made primarily from hardened gypsum plaster. Drywall manufactured in the United States has been traditionally made from pure, naturally occurring gypsum. It has been determined that the drywall manufactured in China was made with a synthetic gypsum. This synthetic gypsum is manufactured with material called “fly ash”, which is a byproduct of coal fired power plants and contains coal combustion byproducts (CCBs). Under certain conditions, including the right combination of heat and moist air, this synthetic gypsum can break down into hydrogen sulfide gas and other sulfide gases.

Tests performed by at least 2 independent consultants have confirmed that in certain instances these sulfide gases can result in corrosion of the copper piping in air handling units. The gases, which emit a strong “rotten egg” smell, also permeate through the household, tarnishing silverware and jewelry. It has not yet been determined whether

there are any significant health risks associated with this defect but many homeowners are complaining of increased allergies, sinus infections, respiratory difficulties and other maladies that they believe are a result of their exposure to the sulfuric gases.

At least one major national homebuilder, Lennar, has acknowledged the problem, begun to attempt corrective measures in the homes in question and has filed suit against the manufacturers, distributors and installers of the drywall in order to recover the damages incurred. Lennar has admitted that the defective drywall is corrosive to metal fixtures in the home, including air conditioning handlers, and that the only remedy for the problem is the complete removal of all drywall from the houses and replacement of all affected mechanical components.

While Lennar is the only developer known to have filed suit to date, numerous plaintiff attorneys throughout the United States, and particularly in Florida, have begun filing class action lawsuits against these larger homebuilders, manufacturers, suppliers and installers.

III. Homebuilder and Developer Liability

Most of the claims to date have been filed by homeowners suing homebuilders/developers such as Lennar and DR Horton, who constructed thousands of homes in the southeastern United States, using the defective drywall. (Most of these suits have also named the manufacturers, distributors and suppliers of the drywall as defendants). It should be expected that any homebuilder who used Chinese drywall will eventually be brought into this litigation. Homeowners will pursue their claims under multiple theories, including, but not limited to, Breach of Contract, Breach of Implied Warranty of Merchantability, Breach of Implied Warranty of Fitness for a Particular Purpose, Violations of The Florida Deceptive and Unfair Trade Practices Act (or similar statutes in other states), Negligence and Unjust Enrichment.

Liability and the theories under which it is based will vary depending on the contractual relationship (or lack thereof) between the homeowner and the homebuilder. Where the homebuilder is in direct contract with the homeowner, the homebuilder will face potential liability on all of the legal theories listed above. Regardless of which theories of recovery are pursued, the liability of the homebuilder/developer to the homeowner with whom they are in direct privity is a virtual certainty. In the situation where the existing homeowner purchased the home from someone other than the builder, the builder's liability will be limited to only a few potential theories, including Negligence and Breach of Express Warranties (to the extent any are still in effect).

The Negligence claims will be based on allegations that the homebuilder breached its duty of care to any subsequent homeowner when it built the home with the defective drywall. This is a more difficult case to prove since there would have to be some indication that the homebuilder actually knew or should have known about the potential defect in the drywall. The statute of limitations in Florida for a claim on a construction defect is four years from the date the homeowner knew or should have known of the defect, with an outside statute of repose of ten years for latent defects.

The claims relating to breaches of the express warranties contained in the original construction contract will be fairly straightforward to the extent the warranties are still in effect at the time the claim is made. Where a homebuilder builds a home for a developer or other owner who then subsequently sells the home to the eventual claimant, the warranties contained in the original contract for construction would pass to the subsequent purchaser and would provide an avenue for recovery from the homebuilder. These warranties are typically measured from the date that the construction is completed (issuance of a Certificate of Occupancy), unless the language of the provision denotes a different trigger. Generally speaking these warranties are anywhere from 1 to 5 years in duration, but this will be a contract specific analysis.

The majority of the complaints filed to date have been against the larger homebuilders and they seek certification of class action status. Given the number of homes built by these large homebuilders, the commonality of the questions of fact and law that exist and the typicality of the claims of all class members, it is likely that class action status will be certified. For smaller builders the question of class certification will be more uncertain and will depend largely on the amount of potentially affected homes. Florida courts have certified class status in claims with as few as 40 class members.

IV. Damages

Complete removal and replacement of the defective drywall appears to be the only remedy. In addition, plaintiffs will seek compensation for the repair, removal and/or replacement of damaged property including, most notably, air conditioning air handlers. As of this date, there has been no substantiated claim of illness due to the product; However, there is widespread anecdotal evidence of homeowners suffering respiratory distress, headaches, sinus inflammation and other maladies as a result of living in the affected homes. Therefore, it should be anticipated that the majority of these lawsuits will include claims for medical monitoring for the health effects of sulfur-emitting drywall and for damages arising out of any such injuries.

V. Developer/homebuilder remedies

Just as the liability of the builders to the homeowners appears likely, in most instances the builders will have solid claims against the manufacturers, distributors, suppliers and installers of the defective drywall based on theories of breach of contract, breach of warranty, common law and statutory indemnity and violations of the Florida Deceptive and Unfair Trade Practices Act. Similarly, each party going up the supply chain should have viable claims against those entities above them in the stream of commerce, with ultimate liability resting with the manufacturer. Nevertheless, given the massive scale of this problem and the likelihood that damages will be in the multiple billions of dollars, homebuilders and developers should not expect that manufacturers, suppliers and installers will have enough coverage available to satisfy all of these claims.

VI. Recommendations

Homebuilders and developers must act quickly and proactively on this issue. First, they must immediately begin to investigate the source of the drywall used in their

construction since 2004. In the case of developers who contracted out with others to provide drywall materials and installation, this will entail reaching out to those installers in an effort to verify the source of their drywall.

If it is determined that any such drywall was used, then a comprehensive plan must be developed to determine exactly which homes have been affected by defective drywall. (It is important to note that not all drywall manufactured in China is defective). This plan should include the use of professional consultants who have the ability to detect and quantify the amount of sulfuric emissions within each house. To the extent that it is determined that defective drywall is in fact present in any of these homes, the homebuilder/developer should attempt to negotiate directly with the homeowner in order to remediate the condition.

As mentioned above, one large homebuilder, Lennar, has already entered into settlements with numerous homeowners and is undertaking the necessary repairs to their homes. In turn, Lennar has already filed suit against the manufacturers, the distributors and suppliers of the drywall in order to recover the damages they have sustained. While this course of action has not prevented Lennar from being named in a number of class action lawsuits, for each homeowner with whom they have successfully reached a settlement, Lennar's exposure to the class action claims has been lessened accordingly.

Builders who pursue this course of action will also gain the important advantage of being able to move forward with their claims against the manufacturers, suppliers and installers of the drywall in a more timely manner. This is likely to become an important consideration given what is sure to be an inadequate pool of insurance coverage. As a practical matter, the earlier a builder begins the process of seeking indemnity from those parties upstream in the supply chain, the more likely that builder is to recover at least a portion of its damages from the insurers of those other entities.

VII. Conclusion

The problem of defective Chinese drywall in the southeastern United States, and especially in Florida, is real and massive. Any builder who used Chinese drywall in the last six years is likely to be pulled into litigation. The available pool of insurance is almost certainly inadequate to cover the total amount of damages that eventually will be sustained. Faced with this dilemma, those homebuilders who move quickly and proactively to determine the extent of their exposure and to attempt to work directly with the affected homeowner will have the best chance to effectuate reasonable settlements and to collect on their claims for indemnification from those parties above them in the chain of commerce.