

LEGAL BRIEF

BARLOW LYDE & GILBERT



Drywall lawsuits will hit reinsurance hard

DRYWALL is an essential material in the construction industry. It is made of gypsum-based plaster pressed between two thick sheets of paper and dried in a kiln. It is light, easy to cut and simple to put up. Drywall is used in most US homes.

When hurricane Katrina struck in 2005, destroying thousands of homes, no-one accurately estimated how much drywall would be needed to rebuild the houses. When homeowners in the southern states of the US started to rebuild their homes using drywall the need for it was such that US-manufactured drywall quickly ran out.

The US needed to import drywall from other countries, particularly China. Some reports indicate 550 million pounds of Chinese drywall has been offloaded at US ports since 2006, enough to build 60,000 average-sized homes.

Unfortunately, Chinese drywall has quickly become the curse of the US southern states. The allegation is Chinese drywall emits gases including carbon disulfide, carbonyl sulphide, hydrogen sulphide and diethyl sulphide resulting in a “rotten egg” smell. Moreover, these gases reportedly corrode metal, especially copper, thus affecting pipes, wiring and air-conditioning equipment.

The long-term health effects of the Chinese drywall are as of yet unknown, but it is alleged it causes respiratory problems, sleeping problems, irritation of the eyes and sinuses, and allergies.

It is unclear what component in the Chinese drywall may have caused the emission of the gases. Some allege it is because Chinese drywall is manufactured using fly ash from scrubbers on coal-fired power plants.

Several class actions and significant lawsuits have already been filed. These are directed against manufacturers, suppliers and installers of the product, alleging they failed to establish proper quality control and provide adequate warnings. It is expected a significant number of additional claims will be filed in the near future, touching everyone involved in the supply chain or construction industry.

A few homeowners have also started actions against their homeowners’ insurance providers. It is thought builders, manufacturers and installers also notified their insurers of this difficulty.

So far, there has been little movement on the part of the insurers, who have yet to take a concerted view on whether to agree or reject these claims or notifications. There are serious insurance coverage issues. It appears most of the cover provided contained pollution, wear and tear and faulty materials exclusions.

This situation also raises a public policy issue, whereby insurers declining cover may be severely criticised. Having said that, one insurer of a homebuilder has already commenced a declaratory judgment action based on the above exclusions.

What are the potential implications for the reinsurance industry? Clearly, the fact that close to 60,000 houses may be at risk indicates the total cost of rectifying the problem may be very substantial.

If we assume US insurers will respond to these claims, this raises aggregation issues on the reinsurance front, particularly whether it can be said all these claims arise from one event or several.

To this effect what would the event be? The manufacturing of the Chinese drywalls, perhaps? Their installation? Additionally, there may be “follow-the-settlement” issues where US insurers may reach compromise settlements even though they had possibilities to exclude these claims.

This issue is one to watch, and we will obviously follow the course of the various lawsuits and actions in the coming months with interest.

Tanguy de Schwarz is an associate director in the reinsurance and international risk team at Barlow Lyde & Gilbert LLP



Chinese drywall covering copper tubes in a US home