DEFECTIVE AND CORROSIVE DRYWALL: ANALYZING FIRST-PARTY COVERAGE ISSUES

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I. INTRODUCTION

The widespread destruction of homes and businesses during the hurricanes of 2004 through 2006 resulted in a boom in housing construction and efforts to restore and rebuild damaged and destroyed buildings.[1]

1. *See* Leslie Wayne, *Chinese Drywall Linked to Corrosion*, N.Y. Times, Nov. 23, 2009, at B6. *See also* Elizabeth Leamy & Susan Rucci, *Some China-Made Drywall Causing a Stink*, ABC News, Mar. 24, 2009, *available at* http://abcnews.go.com/GMA/Consumer/story?id=7146929&page=1.

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This, in turn, led to an increase in price and a decrease in availability of many construction materials, including drywall.[2] As a result, builders along the Gulf Coast and the East Coast began using drywall manufactured in China and imported to the United States.[3] While in many cases drywall was stamped on the back "made in China," some of the drywall manufactured was rebranded to appear that it had been manufactured in the United States.[4]

Subsequently, owners of homes and other structures containing Chinese drywall began reporting problems such as unpleasant odors, blackening and corrosion of metal objects, and problems with electrical wiring, plumbing, appliances, and electronics.[5] In some instances, owners reported the premature failure of electronic and mechanical devices.[6] Homeowners reported health problems such as eye and skin irritation, breathing problems, persistent cough, bloody noses, runny noses, recurrent headaches, sinus infections, and asthma attacks.[7] These symptoms reportedly lessened or disappeared upon leaving the home and recurred upon returning.[8] All of these problems ultimately were linked to Chinese drywall's emission of sulfur gases, such as hydrogen sulfide.[9]

Although much of the drywall that caused these problems was manufactured in China between 2004 and 2008, some drywall manufactured

2. *See* Wayne, *supra* note 1; *see also Chinese Drywall Poses Potential Risks to American Homeowners, Apartment Dwellers*, FOX News, Apr. 11, 2009, *available at* http://www.foxnews.com/story/ 0,2933,514636,00.html.

3. *See* Michael Corkery, *Chinese Drywall Cited in Building Woes*, Wall St. J., Jan. 12, 2009, at A3; Elizabeth Razzi, *Chinese Drywall Linked to Irritation*, Wash. Post, Nov. 24, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/23/AR2009112303944.html; *see also* Wayne, *supra* note 1.

4. *See* Armen Keteyian, *Drywall Blamed for Homeowners' Nightmare*, CBS News, Mar. 26, 2009, *available at* http://www.cbsnews.com/stories/2009/03/26/cbsnews_investigates/main4895737.shtml.

5. *See* Razzi, *supra* note 3.

6. *See* Leslie Wayne, *Chinese Drywall Found to Differ Chemically*, N.Y. Times, Oct. 29, 2009, at B3.

7. *See id.*; *see also* Leslie Wayne, *Thousands of Homeowners Cite Drywall for Ills*, N.Y. Times, Oct. 7, 2009, at B1; Rich Phillips, *Get Out of House with Chinese Drywall, Doctor Tells Family*, CNN, May 6, 2009, *available at* http://articles.cnn.com/2009–05–06/us/florida.chinese.drywall.family _1_chinese-drywall-corrosive-sick?_s=PM:US; Tim Padgett, *Is Drywall the Next Chinese Import Scandal?*, Time, Mar. 23, 2009, *available at* http://www.time.com/time/nation/article/0,8599,188705900.html.

8. *See* Wayne, *supra* note 6.

9. *See* Press Release, U.S. Consumer Prod. Safety Comm'n, Corrosion in Homes and Connections to Chinese Drywall, Nov. 29, 2009, *available at* http://www.cpsc.gov/info/drywall/nov2009statement.pdf; *see also* Jason Hanna, *Florida: Drywall Has Material That Can Emit Corrosive Gas*, CNN, Mar. 24, 2009, *available at* http://www.cnn.com/2009/US/03/24/chinese.drywall/; *Drywall from China Blamed for Problems in Homes*, USA Today, Mar. 16, 2009, *available at* http://www.usatoday.com/money/economy/housing/2009–03–16-chinese-drywall-sulfur_N.htm.

recently in the United States also has been found to emit sulfur gases.[10] This is due to the recycling of waste products, in which drywall originally manufactured in China is incorporated into newly manufactured U.S. drywall.[11] Because the sulfur gas emissions no longer are confined to drywall manufactured in China,[12] any drywall that emits sulfur gases is referred to as defective and corrosive drywall.

Many lawsuits have been filed in state and federal courts in various jurisdictions (including Florida, Alabama, Louisiana, and Virginia) against builders, developers, installers, Realtors, brokers, suppliers, importers, exporters, distributors, and manufacturers that were involved in the manufacture, sale, distribution, and use of defective and corrosive drywall or with properties containing it. On June 19, 2009, a number of federal cases involving defective and corrosive drywall were transferred and consolidated as multidistrict litigation in the case of *In re Chinese-Manufactured Drywall Product Liability Litigation*,[13] before Judge Eldon E. Fallon in the U.S. District Court for the Eastern District of Louisiana. Since then, other similar cases have been filed in various state and federal courts, usually by building owners seeking to recover under their first-party insurance policies for damages.[14]

This article will analyze some of the coverage issues involved in first-party claims for property damage caused by defective and corrosive drywall, including the potential applicability of policy exclusions, and will include a review of recent decisions in federal and state courts involving coverage for losses caused by defective and corrosive drywall.

II. FIRST-PARTY PROPERTY CLAIMS

Unlike third-party liability claims involving the defense and indemnity of the insured against claims by third parties arising out of the alleged

10. *See* Aaron Kessler, *Another Drywall Mystery Inside the Walls*, Sarasota (Fla.), Herald Trib., May 1, 2009, at A1; *see also Homeowners Charge U.S. Made Toxic Drywall*, CBS News, Nov. 23, 2009, *available at* http://www.cbsnews.com/stories/2009/11/23/cbsnews_investigates/main5752469.shtml; Amy Hoak, *Toxic Drywall Problem a Headache for Unlucky Homeowners*, St. Petersburg Times, June 12, 2010, *available at* http://www.tampabay.com/features/homeandgarden/toxic-drywall-problem-a-headache-for-unlucky-homeowners/1101644.

11. *See* Cristela Guerra, *American Drywall Is Faulty, Too*, News-Press (Fla.), Sept. 29, 2010, http://www.news-press.com/article/20100929/NEWS0103/9290320/American-drywall-is-faulty-too.

12. *See* U.S. Consumer Prod. Safety Comm'n, Dep't of Hous. & Urban Dev., Interim Guidance—Identification of Homes with Corrosion from Problem Drywall (Jan. 28, 2010), *available at* www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf.

13. MDL No. 2047, 2010 U.S. Dist. LEXIS 8686 (E.D. La. Apr. 8, 2010).

14. For example, a class action complaint was recently filed on behalf of 102 homeowners against 182 insurance companies based upon the insurers' denial of coverage in connection with losses to plaintiffs' homes caused by or resulting from defective or corrosive drywall. *See* Complaint, Hernandez v. AAA Ins., No. 10-3070 (E.D. La. Sept. 15, 2010).

negligence of the insured, first-party property claims deal with the extent of financial protection owed to the insured for losses arising out of damage to insured property.[15] Coverage for first-party claims is based upon the terms and conditions of the insurance contract[16] and requires a two-step inquiry. First, a determination is made as to whether coverage for a loss exists under the general insuring provisions of the insurance policy.[17] Second, a decision is made as to whether any policy exclusions apply to negate coverage.[18] It is well settled that once an insured meets its initial burden of establishing that a loss is covered under the policy, the burden then shifts to the insurer to demonstrate the applicability of a policy exclusion.[19]

To prove coverage for a loss, the insured first must establish that the property involved is covered property under the terms of the policy.[20] "Covered property" as defined in a first-party policy typically includes the insured's structure and all parts of the structure, including drywall and fixtures. Once the insured establishes that a claim involves covered property, it then must establish that a covered loss has occurred within the policy period.[21]

A. *Direct Physical Loss*

First-party property policies generally provide coverage for "direct physical loss," a term that is not usually defined in the policies.[22] Coverage

15. *See* Anthem Elecs., Inc. v. Pac. Emp'rs Ins. Co., 302 F.3d 1049, 1054 (9th Cir. 2002); State Farm Mut. Auto. Ins. Co. v. Roberts, 697 A.2d 667, 670 (Vt. 1997); Mission Nat'l Ins. Co. v. Coachella Valley Water Dist., 210 Cal. App. 3d 484, 491 (1989).

16. *See* San Jose Crane & Rigging, Inc. v. Lexington Ins. Co., 227 Cal. App. 3d 1314, 1319 (1991).

17. *See, e.g.*, Goomar v. Centennial Life Ins. Co., 855 F. Supp. 319, 326–27 (S.D. Cal. 1994); Scottsdale Ins. Co. v. Great Am. Assur. Co., 610 S.E.2d 558, 560 (Ga. Ct. App. 2005); Grossman Iron & Steel Co. v. Bituminous Cas. Corp., 558 S.W.2d 255, 259 (Mo. Ct. App. 1977).

18. *See, e.g.*, Taylor-Morley-Simon, Inc. v. Mich. Mut. Ins. Co., 645 F. Supp. 596, 599 (E.D. Mo. 1986); Bradshaw v. St. Paul Fire & Marine Ins. Co., 226 F. Supp. 569, 574 (N.D. Ga. 1964); Physicians Ins. Exch. v. Jennings, 736 N.E.2d 179, 192 (Ill. App. Ct. 2000).

19. *See, e.g.*, Mt. Vernon Fire Ins. Co. v. Stagebands, Inc., 636 F. Supp. 2d 143, 147 (D.R.I. 2009); Nat'l Union Fire Ins. Co. v. Structural Sys. Tech., Inc., 756 F. Supp. 1232, 1238 (E.D. Mo. 1991); Gen. Accident Ins. Co. of Am. v. Am. Nat'l Fireproofing, 716 A.2d 751, 757 (R.I. 1998); Queen City Farms v. Cent. Nat'l Ins. Co., 827 P.2d 1024, 1041 (Wash. Ct. App. 1992); Pac. Indem. Co. v. Kohlhase, 455 P.2d 277, 279 (Ariz. Ct. App. 1969).

20. *See, e.g.*, Living Word Bible Church, Inc. v. Travelers Indem. Co., 2009 U.S. Dist. LEXIS 79011, at *5 (E.D. La. Sept. 1, 2009); Yale Univ. v. CIGNA Ins. Co., 224 F. Supp. 2d 402, 412 (D. Conn. 2002); Victory Peach Group v. Greater N.Y. Mut. Ins. Co., 707 A.2d 1383, 1384 (N.J. Super. Ct. App. Div. 1998).

21. Transam. Leasing, Inc. v. Inst. of London Underwriters, 267 F.3d 1303, 1310 (11th Cir. 2001); N.H. Ins. Co. v. Martech USA, Inc., 993 F.2d 1195, 1199 (5th Cir. 1993).

22. *See, e.g.*, 1 Susan J. Miller & Philip Lefebvre, Miller's Standard Insurance Policies Annotated 206 § 1.A.A (Form HO00031000), 455.6 § A (Form CP00100402), 502.1 § l.A (Form BP00030106) (5th ed. 2007). *See also* 10 Lee R. Russ Couch on Insurance § 148:46 (3d ed. 1998).

under an all-risk property insurance policy is predicated on physical loss or damage to the insured property.[23] To trigger coverage for damage to the insured premises, an accidental event resulting in a direct physical loss not otherwise excluded by the policy must occur.[24]

In general, the insured must present some evidence of physical injury in order to prove a direct physical loss. In *Trinity Industries, Inc. v. Insurance Co. of North America*,[25] the court noted that the language "physical loss or damage" in an all-risk policy "strongly implies that there was an initial satisfactory state that was changed by some external event into an unsatisfactory state."[26]

In *Columbiaknit, Inc. v. Affiliated FM Insurance Co.*,[27] the court examined whether the insured's claim for a total loss was covered under an all-risk insurance policy where some, but not all, of the insured's goods were damaged by mold and mildew. The court noted that under an all-risk policy, "[t]he requirement that the loss be 'physical,' given the ordinary definition of that term, is widely held to exclude alleged losses that are intangible or incorporeal, and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property."[28] The court then held that the insured must show the existence of distinct and demonstrable physical damage in order to establish that a covered loss has occurred.[29]

Similarly, in *Mastellone v. Lightning Rod Mutual Insurance Co.*,[30] the court held that the mere presence of mold on the surface of the exterior siding of a house did not constitute direct physical damage as required by the policy because "[t]he presence of mold did not alter or otherwise affect the structural integrity of the siding" and because the mold "could be removed without causing any harm to the wood."[31] A different result was obtained in *Prudential Property & Casualty Insurance Co. v. Lillard-Roberts*,[32] where the

23. *See* Columbiaknit, Inc. v. Affiliated FM Ins. Co., 1999 U.S. Dist. LEXIS 11873, at *7–8 (D. Or. Aug. 4, 1999).

24. *See* Maister Assocs. v. State Farm Fire & Cas. Co., 2009 U.S. Dist. LEXIS 27544, at *9 (E.D. La. Mar. 1, 2009).

25. 916 F.2d 267 (5th Cir. 1990).

26. *Id.* at 270–71.

27. 1999 U.S. Dist. LEXIS 11873.

28. *Id.* at *9 (quoting 10 Couch on Insurance, *supra* note 22, § 148:46); *see also* Wyo. Sawmills, Inc. v. Transp. Ins. Co., 578 P.2d 1253, 1256 (Or. 1978) (inclusion of the word "physical" in an insurance policy "negate[d] any possibility that the policy was intended to cover 'consequential or intangible damage' " (citation omitted)).

29. *Columbiaknit*, 1999 U.S. Dist. LEXIS 11873, at *17–18.

30. 884 N.E.2d 1130 (Ohio Ct. App. 2008).

31. *Id.* at 1145.

32. 2002 U.S. Dist. LEXIS 20387 (D. Or. June 18, 2002).

court found that visible mold contamination that may not be removable was "distinct and demonstrable" damage and therefore sufficient to constitute a "direct" and "physical" loss under an "all-risk" policy.[33]

A number of courts have held that economic loss caused by the presence of a defect in the construction of a building does not constitute a direct physical loss under a first-party property insurance policy. In *Pirie v. Federal Insurance Co.*,[34] the court held that the cost of removing lead paint from a house was not covered under the insured's homeowner's property insurance policy because the presence of lead paint was not a direct physical loss.[35] In *Port Authority v. Affiliated FM Insurance Co.*,[36] the Third Circuit held that "[t]he mere presence of asbestos or the general threat of its future release [was] not enough . . . to show a physical loss or damage [which would] trigger coverage under a first-party 'all risks' policy."[37] In *Great Northern Insurance Co. v. Benjamin Franklin Savings & Loan Association*,[38] the court held that the cost of removing asbestos-containing insulation from a building was not covered by an insurance policy covering only direct physical loss, since the insured building remained physically intact and undamaged by the asbestos and the only loss incurred by the insured was the cost of removing the asbestos, which was a mere economic loss and therefore not covered under the policy.[39] Similarly, in *Trinity Industries, Inc. v. Insurance Co. of North America*,[40] the Fifth Circuit held that an all-risk policy covered damages to the insured property "resulting from defective design or workmanship, but not the cost of repairing the defect itself."[41]

In contrast, a defect in the insured property caused by an external source has been held to constitute a "direct physical loss" under a first-party policy. In *Widdows v. State Farm Florida Insurance Co.*,[42] the court held that an abnormality that developed in the plumbing system of a house, which abnormality was caused by external forces that changed the position of the pipe over time, but which was not caused by a defect in the construction of the house, was an "accidental direct physical loss,"

33. *Id.* at *26.
34. 696 N.E.2d 553 (Mass. App. Ct. 1998).
35. *Id.* at 555 (citing HRG Dev. Corp. v. Graphic Arts Mut. Ins. Co., 527 N.E.2d 1179, 1181 (1988) (defect in title not covered under all-risk insurance policy because no direct physical loss)).
36. 311 F.3d 226 (3d Cir. 2002).
37. *Id.* at 236.
38. 793 F. Supp. 259 (D. Or. 1990).
39. *Id.* at 263.
40. 916 F.2d 267 (5th Cir. 1990).
41. *Id.* at 270–71.
42. 920 So. 2d 149 (Fla. Dist. Ct. App. 2006).

and it was not necessary to establish damage to the premises resulting from the abnormality in order to recover for the cost of repairing the abnormality.[43]

Other courts have held that coverage for claims to recover the costs of repair or replacement of defective construction work—rather than claims for accidents or damages to the insured property resulting from the defective work—is precluded by the all-risk insurance policy language limiting coverage to "direct physical loss."[44]

B. *Whether Defective and Corrosive Drywall Has Caused a Direct Physical Loss*

It is apparent from a review of the general case law that the mere presence of defective and corrosive drywall, without more, is not sufficient to establish a direct physical loss, which is required for coverage under a first-party property policy. However, it appears under certain circumstances, various types of damages caused by defective and corrosive drywall, such as odors, health problems, and corrosion of metal and electronic components, can constitute forms of direct physical loss.

Looking first at the issue of odor, courts repeatedly have held in other contexts that an odor can constitute a direct physical loss where the extent and intensity of the odor equate to physical damage to the house. In *Farmers Insurance Co. v. Trutanich*,[45] the court found that odors from the production of methamphetamine had infiltrated the house to the point of causing physical damage, such that the cost of removing the odor was a direct physical loss.[46] In reaching that conclusion, the court relied upon the case of *Western Fire Insurance Co. v. First Presbyterian Church*,[47] in which the court held that a direct physical loss to the insured building had occurred when gasoline infiltrated the soil surrounding the building's basement,

43. *Id*. at 150.

44. *See, e.g*., Whitaker v. Nationwide Mut. Fire Ins. Co., 115 F. Supp. 2d 612, 616 (E.D. Va. 1999); John S. Clark Co. v. United Nat'l Ins. Co., 304 F. Supp. 2d 758, 765-66 (M.D.N.C. 2004) (defects caused by faulty workmanship or negligent construction do not constitute physical loss or damage under all-risk policy); City of Burlington v. Indem. Ins. Co. of N. Am., 332 F.3d 38, 44 (2d Cir. 2003) (coverage under policy insuring against "risks of direct physical loss or damage to the property insured" did not cover "the costs of repairing . . . defective welds that had not yet failed"); Wolstein v. Yorkshire Ins. Co., 985 P.2d 400, 408 (1999) (coverage under policy insuring "against all risks of physical loss of or damage" did not cover costs to repair faulty workmanship or faulty initial construction); *see also* Bethesda Place Ltd. P'ship v. Reliance Ins. Co., 1992 U.S. Dist. LEXIS 6522, at *9 (D. Md. Apr. 22, 1992) ("case law does not support the argument that a design defect in and of itself constitutes physical injury or damage to property from an external cause").

45. 858 P.2d 1332 (Or. Ct. App. 1993).

46. *Id*. at 1335.

47. 437 P.2d 52 (Colo. 1968).

contaminating the building's foundation and rooms and rendering the use of the building dangerous.[48] Following the same line of reasoning, the court in *Arbeiter v. Cambridge Mutual Fire Insurance Co.*[49] adopted the rationale from *Trutanich* in holding that oil fumes were "a physical loss which attaches to the property."[50] Likewise, in *Essex Insurance Co. v. BloomSouth Flooring Corp.*,[51] the First Circuit found that offensive odor from an improperly installed carpet that permeated the building constituted a physical loss.[52] Therefore, it appears clear that odor alone can constitute a direct physical loss to the extent the odor is sufficiently severe and pervasive.

Even in the absence of actual physical damage to the insured structure itself, an insured property that has been rendered unusable or uninhabitable can constitute a direct physical loss.[53] In *Matzner v. Seaco Insurance Co.*,[54] the court held that carbon monoxide contamination of an apartment building that rendered the building uninhabitable was covered as a direct physical loss.[55] Likewise, in *Murray v. State Farm Fire & Casualty Co.*,[56] the court found that a direct physical loss under an all-risk homeowner's policy had occurred where houses were rendered uninhabitable due to the risk of imminent landslides.[57]

Because contamination caused by defective and corrosive drywall may fairly be analogized to asbestos contamination, it is instructive to review case law considering whether asbestos contamination constitutes a direct physical loss for a first-party property claim. Although most cases dealing with insurance and asbestos involve third-party claims and general liability claims, which are not applicable here, a few courts have addressed first-party claims for asbestos contamination of a building. For example, in *Sentinel Management Co. v. New Hampshire Insurance Co.*,[58] the court found that a direct physical loss had occurred where "released asbestos fibers . . . contaminated the [apartment] buildings" and "creat[ed] a hazard to human health." The court explained that "[a]lthough asbestos contamination does

48. *Id.* at 55.
49. 1996 Mass. Super. LEXIS 661 (Mar. 15, 1996).
50. *Id.* at *3–4.
51. 562 F.3d 399 (1st Cir. 2009).
52. *Id.* at 405–06.
53. It is important to note that the decisions holding that a structure that has been rendered unfit for occupancy are not based upon any health problems of the occupants, but instead are based upon the damage to the property caused by the condition that renders the structure uninhabitable. *See infra* Part II.B.
54. 1998 Mass. Super. LEXIS 407 (Aug. 26, 1998).
55. *Id.* at *13.
56. 509 S.E.2d 1 (W. Va. 1998).
57. *Id.* at 17.
58. 563 N.W.2d 296 (Minn. Ct. App. 1997).

not result in tangible injury to the physical structure of a building, a building's function may be seriously impaired or destroyed and the property rendered useless by the presence of contaminants."[59] Likewise, in *Yale University v. CIGNA Insurance Co.*,[60] the court held that even though an all-risk policy does not cover "costs incurred due to the mere presence of asbestos and lead containing materials in its buildings," asbestos contamination constitutes physical loss and damage to property under an all-risk policy based on "the substantial body of case law in which a variety of contaminating conditions have been held to constitute 'physical loss of or damage to property.' "[61]

Conversely, in *Port Authority v. Affiliated FM Insurance Co.*,[62] the Third Circuit held that the mere presence of asbestos-containing materials was not sufficient to establish a physical loss under a first-party all-risk policy. The court explained:

> In the case before us, the policies cover "physical loss," as well as damage. When the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, then there has been a distinct loss to its owner. However, if asbestos is present in components of a structure, but is not in such form or quantity as to make the building unusable, the owner has not suffered a loss. The structure continues to function—it has not lost its utility. The fact that the owner may choose to seal the asbestos or replace it with some other substance as part of routine maintenance does not bring the expense within first-party coverage.[63]

Likewise, the court in the recent case of *Universal Image Products v. Chubb Corp.*[64] found that a first-party claim for odors and mold was not covered under an all-risk insurance policy because the insured property did not suffer any structural or other tangible damage, but instead merely suffered intangible harm from "strong odors and the presence of mold and/or bacteria in the air and ventilation system."[65] The court held that this case was distinguishable from *Trutanich*, *Matzner*, and *Western Fire Insurance* because there was "no evidence that the stench was so pervasive as to render the premises uninhabitable."[66]

Based on these cases, it appears that odors caused by defective and corrosive drywall can constitute a direct physical loss under a first-party

59. *Id.* at 300.
60. 224 F. Supp. 2d 402 (D. Conn. 2002).
61. *Id.* at 412–13.
62. 311 F.3d 226 (3d Cir. 2002).
63. *Id.* at 236.
64. 703 F. Supp. 2d 705 (E.D. Mich. 2010).
65. *Id.* at 710.
66. *Id.*

property policy, so long as either (a) the odor has permeated the structure and rendered it uninhabitable due to its intensity and pervasiveness or (b) health problems have resulted from the sulfurous off-gassing from the defective and corrosive drywall.

Although the mere presence of defective and corrosive drywall does not appear to constitute a direct physical loss under first-party property policies, the different types of damage caused by defective and corrosive drywall, such as odors and corrosion of metal and electronic components, do appear to constitute forms of direct physical loss covered by such policies. This conclusion is supported by the recent decisions in *Travco Insurance Co. v. Ward*[67] and the recent multidistrict litigation decision *In re Chinese-Manufactured Drywall Product Liability Litigation*,[68] in which the courts held that damage allegedly caused by defective and corrosive drywall constituted a "direct physical loss" under first-party property insurance policies.[69]

In *Ward*, Travco Insurance Company filed a declaratory judgment action after denying a claim by the owner for coverage under a homeowners policy for the cost of removing and/or replacing the defective and corrosive drywall in the house and for the damages to the owner's air-conditioning system, garage door, and flat screen televisions allegedly caused by the drywall.[70] The court reviewed cases from other jurisdictions, including *Farmers Insurance Co. v. Trutanich* and *Western Fire Insurance Co. v. First Presbyterian Church* (both discussed *supra*), which held that actual physical damage to the property is not necessary where the building has been rendered unusable.[71] Because the house was "rendered uninhabitable by the toxic gases released by the Chinese Drywall" and because the policy's definition of "property damage," which included "loss of use of tangible property," indicated that the parties intended to define "direct physical loss" to include total loss of use, the court held that the house and its contents suffered a "direct physical loss" within the meaning of the policy.[72]

In the recent multidistrict litigation decision, the court considered ten dispositive motions, consisting of eight motions to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) and two motions for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c), which were filed by homeowners' insurance carriers concerning claims for coverage brought under "all-risk" homeowners insurance policies for damage to houses caused by Chinese-manufactured

67. 715 F. Supp. 2d 699 (E.D. Va. 2010), *appeal docketed*, No. 10-1710 (4th Cir. June 24, 2010).
68. MDL No. 2047, 2010 U.S. Dist. LEXIS 133497 (E.D. La. Dec. 16, 2010).
69. *Ward*, 715 F. Supp. 2d at 708.
70. *Id*. at 703–04.
71. *Id*. at 708–09 (citing Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1336 (Or. Ct. App. 1993); W. Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 55 (Colo. 1968)).
72. *Id*. at 709–10.

drywall.[73] The insurers argued that the plaintiff homeowners failed to meet their burden of alleging a covered claim for the property damage caused by the Chinese-manufactured drywall under the Fifth Circuit's definition of "physical loss" in *Trinity Industries v. Insurance Co. of North America*[74] because the Chinese-manufactured drywall was installed in the homes in an "unsatisfactory" manner and was not rendered unsatisfactory by an "external event."[75] After noting that neither the homeowners' insurance policies nor the Louisiana Supreme Court provided definitions for "physical loss" or the terms "direct," "accidental," or "sudden" as the terms applied to "physical loss," the court in the multidistrict litigation found that the common meaning of the terms as provided in dictionary definitions suggested that the Chinese drywall-related losses were covered by the policies because the drywall had caused a "distinct, demonstrable, physical alteration" of the covered property by corroding the silver and copper elements in the homes.[76] The court then considered decisions from other courts, including *Port Authority v. Affiliated FM Insurance Co*., *Farmers Insurance Co. v. Trutanich*, and *Western Fire Insurance Co. v. First Presbyterian Church* (discussed *supra*), and held that, while the mere presence of a potentially injurious material in a home may not qualify as a covered physical loss under homeowners insurance policies, activation of the injurious material, such as through the release of gases or fibers, does constitute a covered physical loss under homeowners insurance policies.[77] After noting that the court in *Travco Insurance v. Ward* found that the presence of Chinese-manufactured drywall in a home constitutes a direct physical loss under a homeowners insurance policy,[78] the court in the multidistrict litigation found that the *Trinity* decision cited by the insurers was distinguishable since it involved a builders risk policy, which is different in nature and purpose from a homeowners insurance policy, and since no court in the twenty years since the *Trinity* decision had applied its definition of "physical loss" under a homeowners insurance policy dispute under Louisiana law.[79] The court then held that the alleged damage to the insureds' homes caused by the Chinese-manufactured drywall constituted a covered "physical loss" under the homeowners insurance policies.[80] The court further found that,

73. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, 2010 U.S. Dist. LEXIS 133497, at *3–4.
74. 916 F.2d 267, 270–71 (5th Cir. 1990).
75. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, 2010 U.S. Dist. LEXIS 133497, at *12–13 (E.D. La. Dec. 16, 2010).
76. *Id*. at *14–16.
77. *Id*. at *16–18.
78. *Id*. at *18–19.
79. *Id*. at *20.
80. *Id*. at *21.

because the insureds alleged that the damage was solely caused by or the result of the Chinese drywall, the damages were "direct physical losses" under the homeowners insurance policies.[81]

Based on the recent decisions in *Ward* and the multidistrict litigation, which followed the long line of cases holding that a structure that has been rendered unusable or uninhabitable has suffered a direct physical loss under a first-party property policy, it appears that damage caused by defective and corrosive drywall may constitute a "direct physical loss" under the terms of such a policy.

C. *Policy Exclusions*

Once an insured establishes that a direct physical loss has occurred to covered property, the burden shifts to the insurer to prove the applicability of any policy exclusions that might operate to bar coverage.[82] Many insurers have cited policy exclusions for pollution, corrosion, faulty materials and/or construction, inherent vice, and latent defect, any of which potentially may apply to first-party claims for damages caused by defective and corrosive drywall.

1. Pollution Exclusion

Many first-party property policies exclude coverage for losses caused by "the discharge, dispersal, seepage, migration or release or escape of pollutants."[83] Pollutants generally are defined in the policies as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."[84]

There are few cases that deal with pollution exclusions in first-party property policies, since the majority of cases dealing with the interpretation of a pollution exclusion involve general liability policies. However, among the first-party cases, the majority of courts have applied pollution exclusions in property policies regardless of the source of the pollution. For example, in *Brown v. American Motorists Insurance Co.*,[85] homeowners filed a claim under their property policy after fumes from a chemical

81. *Id.* at *22–23. The court in the multidistrict litigation also found that the losses were "sudden" and "accidental" within the meaning of those homeowners insurance policies, which required that the physical losses be "sudden" or "accidental" in order for coverage to exist. *Id.* at *23–25.

82. Tower Auto., Inc. v. Am. Prot. Ins. Co., 266 F. Supp. 2d 664, 668 (W.D. Mich. 2003); Yale Univ. v. CIGNA Ins. Co., 224 F. Supp. 2d 402, 411 (D. Conn. 2002).

83. *See, e.g.*, Miller & Lefebvre, *supra* note 22, at 238 § 15 (Form HOEX), 470.5 § B.1.2 (Form CP10301000), 503.8 § I.B.2.j (Form BP00030106).

84. *See, e.g.*, *id.* at 238 § 15 (Form HOEX), 504.9 § I.H.10 (Form BP00030106).

85. 930 F. Supp. 207 (E.D. Pa. 1996).

waterproofing sealant applied to the exterior of their home "caused them intense physical discomfort" and required them to vacate their home.[86] The court found that the policy's definition of a "pollutant" as "solid, liquid and gaseous irritants and contaminants, including fumes and vapors," was "clear and unambiguous, and include[d] the fumes that [the homeowners] claim[ed] caused them sufficient irritation to make them vacate their home."[87] Because it was undisputed that "the fumes seeped or migrated into the house," the court held that the homeowners' claim "fell within the plain language of the pollution exclusion," and therefore was outside the coverage provided by the policy.[88]

In *Great Northern Insurance Co. v. Benjamin Franklin Federal Savings & Loan Association*,[89] homeowners sought coverage under a property policy for the cost of removing asbestos from their house.[90] The court held that the policy's pollution exclusion was applicable to asbestos because it specifically excluded coverage for "solid irritants."[91] Similarly, in *Hanover New England Insurance Co. v. Smith*,[92] the insureds sought coverage under their property policy for damage that was caused by heating oil that leaked into the cellar.[93] The court held that the policy's exclusion for losses caused by the "release, discharge, or dispersal of contaminants or pollutants" barred coverage because the loss was caused directly by the release of a contaminant.[94]

However, the court in *Arnold v. Cincinnati Insurance Co*.[95] held that a property policy's pollution exclusion did not apply to a claim for water damage to the interior of a house that resulted when a chemical used to strip the cedar siding on the exterior of the house caused damage to the caulking around the house's windows.[96] The court explained that regardless of whether the stripping chemical met the policy definition of a "pollutant," the loss was not caused by the "discharge, dispersal, seepage, migration, release or escape" of a pollutant because the stripping chemical was deliberately applied to the siding, and therefore the policy's pollution exclusion did not apply.[97]

86. *Id*. at 207–08.
87. *Id*. at 208.
88. *Id*. at 209.
89. 793 F. Supp. 259 (D. Or. 1990).
90. *Id*. at 261.
91. *Id*. at 263.
92. 621 N.E.2d 382 (Mass. App. Ct. 1993).
93. *Id*.
94. *Id*. at 383.
95. 688 N.W.2d 708 (Wis. Ct. App. 2004).
96. *Id*. at 768–69.
97. *Id*. at 787–89.

Some courts decline to apply pollution exclusions in property policies unless the alleged injury was caused by traditional environmental pollution. For instance, in *Thompson v. Temple*,[98] homeowners brought a claim for damages caused by carbon monoxide gas leaking from a bathroom heater.[99] The court found that the pollution exclusion in the property policy did not bar coverage because the pollution exclusion was "intended to exclude coverage only for active industrial polluters, when businesses knowingly emitted pollutants over extended periods of time."[100] The decision in *Thompson* is consistent with a long line of cases in Louisiana holding that a pollution exclusion in a liability policy was intended by the insurance industry to "exclude coverage only for entities which knowingly pollute the environment over a substantial period of time."[101]

The split among jurisdictions regarding the interpretation of the pollution exclusion in first-party cases mirrors the similar split that exists among jurisdictions in third-party liability cases. In one line of cases, the courts have held that the pollution exclusion in a liability policy is clear and unambiguous and thus precludes coverage for all pollution-related damages.[102] The courts in the other line of cases have held that the pollution exclusion

98. 580 So. 2d 1133 (La. Ct. App. 1991).

99. *Id*. at 1134.

100. *Id*. at 1135.

101. *Id*.; *see also* Doerr v. Mobil Oil Corp., 774 So. 2d 119, 129–32 (La. 2000) (summarizing history of litigation over application of pollution exclusions in liability policies in Louisiana).

102. *See*, *e.g*., Yale Univ. v. CIGNA Ins. Co., 224 F. Supp. 2d 402, 423 (D. Conn. 2002) (claim for asbestos contamination excluded by all-risk policies' "contaminant or pollutant" exclusion); Deni Assocs. v. State Farm Fire & Cas. Ins. Co., 711 So. 2d 1135, 1140–41 (Fla. 1998) (claims for release of chemical fumes from ammonia spill and for injuries from spraying of pesticide excluded from coverage under pollution exclusion); W. Am. Ins. Co. v. Band & Desenberg, 925 F. Supp. 758, 762 (M.D. Fla. 1996) (unambiguous language of pollution exclusion bars coverage under policy for injuries from contaminants in building's air resulting from "poorly designed air conditioning system [which] . . . allowed air-borne contaminants from . . . attic space into . . . building's office space"); Bituminous Cas. Corp. v. RPS Co., 915 F. Supp. 882, 884 (W.D. Ky. 1996) (insurer not liable for injuries caused by ammonia spill because liability policy's pollution exclusion precluded coverage); Am. States Ins. Co. v. Nethery, 79 F.3d 473, 475–76 (5th Cir. 1996) (under Mississippi law claims for injuries from paint and glue fumes during home renovation excluded by pollution exclusion in general liability policy); Nat'l Elec. Mfrs. Ass'n v. Gulf Underwriters Ins. Co., 162 F.3d 821, 825–26 (4th Cir. 1998) (under District of Columbia law pollution exclusion not limited to environmental pollution and therefore welder's claims for neurological injuries caused by exposure to manganese fumes during welding not covered); McGuirk Sand & Gravel v. Meridian Mut. Ins. Co., 559 N.W.2d 93, 97 (Mich. Ct. App. 1996) (pollution exclusion clearly and unambiguously excluded claim for petroleum contamination of property); Tech. Coating Applicators, Inc. v. U.S. Fid. & Guar. Co., 157 F.3d 843, 846 (11th Cir. 1998) (under Florida law, absolute pollution exclusion in general liability policy "unambiguously excluded coverage for bodily injuries sustained by breathing vapors emitted from . . . roofing products"); Essex Ins. Co. v. Tri-Town Corp., 863 F. Supp. 38, 40–41 (D. Mass. 1994) (pollution exclusion barred coverage for injuries from carbon monoxide emitted from ice resurfacing machine because incident fell

clause in a liability policy applies only to injuries caused by traditional environmental pollution.[103]

Entrenched in the latter group, Louisiana courts have consistently held that the pollution exclusion in a liability policy was intended by the insurance industry to "exclude coverage [only] for entities which knowingly pollute the environment over a substantial period of time."[104] One seminal case is *Doerr v. Mobil Oil Corp.*,[105] in which the plaintiff sued for injuries resulting from water that was contaminated by discharge from an oil refinery.[106] The *Doerr* court summarized prior cases construing pollution exclusions, then noted that it was "'appropriate to construe [a] pollution exclusion . . . in light of its . . . purpose," which was "'strengthen[ing] environmental protection standards by imposing the full risk of loss due to personal injury or property damage from pollution upon the polluter by eliminating the option of spreading that risk through insurance coverage.'"[107] The court then held that

> [t]he applicability of a total pollution exclusion . . . must . . . turn on [three] considerations: (1) [w]hether the insured is a "polluter" within the meaning of the exclusion; (2) [w]hether the injury-causing substance is a "pollutant" within the meaning of the exclusion; and (3) [w]hether there was "discharge, dispersal, seepage, migration, release or escape" of a pollutant by the insured within the meaning of the policy.[108]

within scope of exclusion once carbon monoxide was released into atmosphere of skating rink); Peace v. Nw. Nat'l Ins. Co., 596 N.W.2d 429, 431 (Wis. 1999) (policy's pollution exclusion bars coverage for lead poisoning injuries because lead in paint in residential property is pollutant, and "when lead-based paint either chips, flakes, or deteriorates into dust . . . , that action is a discharge, dispersal, release, or escape within the meaning of terms" of pollution exclusion).

103. *See*, *e.g.*, Meridian Mut. Ins. Co. v. Kellman, 197 F.3d 1178, 1183 (6th Cir. 1999) (under Michigan law claim for injuries from fumes resulting from floor sealant chemicals not barred by liability policy's pollution exclusion because no reasonable person could find that policy unambiguously excluded coverage for injuries suffered by employee legitimately in immediate vicinity of chemicals); W. Am. Ins. Co. v. Tufco Flooring E., Inc., 409 S.E.2d 692, 698–700 (N.C. Ct. App. 1991) (liability policy's pollution exclusion did not apply to claim for damages from use of chemicals in installation of industrial flooring because contaminant that caused damage was not pollutant under pollution exclusion and because pollution exclusion clause applies only to discharges into environment, which did not occur); Enron Oil Trading & Transp. Co. v. Walbrook Ins. Co., 132 F.3d 526, 530 (9th Cir. 1997) (under Montana law, pollution exclusion did not bar coverage for claim for injection of impurities into oil pipeline because pollution exclusion applies only to environmental harm); Atl. Mut. Ins. Co. v. McFadden, 595 N.E.2d 762, 764 (Mass. 1992) (claim for lead poisoning under general liability policy not excluded by pollution exclusion because policy definition of pollutant does not include leaded materials and because language of pollution exclusion only includes industrial pollution).

104. Thompson v. Temple, 580 So. 2d 1133, 1135 (La. Ct. App. 1991).

105. 774 So. 2d 119 (La. 2000).

106. *Id.* at 122–23.

107. *Id.* at 127 (quoting 9 Couch on Insurance, *supra* note 22, §§ 127:6, 127:6 n.7).

108. *Id.* at 135.

Since *Doerr*, the Louisiana courts have consistently held that pollution exclusions apply only to environmental pollution and must be analyzed using the three-part *Doerr* test.[109]

The only three cases so far in which the courts have weighed in on coverage issues under a first-party property insurance policy for damage allegedly caused by defective and corrosive drywall have been the recent decision issued by a Louisiana court in *Finger v. Audubon Insurance Co.*,[110] the even more recent decision issued in *Travco Insurance Co. v. Ward*,[111] and the still more recent decision in the multidistrict litigation.[112] The *Ward* court reached the opposite conclusion from the Louisiana courts in the other two cases, which reflects the conflict between jurisdictions regarding whether pollution exclusions apply only to cases of traditional environmental pollution or apply to cases involving all types of pollution regardless of the source.

In the *Finger* case, the insureds brought suit in state court, alleging breach of contract because the insurer denied coverage under an all-risk homeowners policy for damages to the house and its contents caused by defective drywall.[113] The insurers denied the insureds' claims and raised a number of affirmative defenses.[114] The court granted the insureds' motion to strike the insurer's affirmative defenses based upon the following policy exclusions: pollution or contamination; gradual or sudden loss; and faulty, inadequate, or defective planning.[115]

In striking the insurer's affirmative defense based upon the pollution or contamination exclusion, the *Finger* court stated the exclusion "does not, and was never intended, to apply to residential homeowners' claims for damages caused by substandard building materials."[116] In reaching that conclusion, the *Finger* court applied the three-part test enumerated in *Doerr* and *State Farm Insurance Co. v. M.L.T. Construction Co*.[117] As further

109. *See*, *e.g.*, Grefer v. Travelers Ins. Co., 919 So. 2d 758, 768 (La. Ct. App. 2005); State Farm Fire & Cas. Co. v. M.L.T. Constr. Co., 849 So. 2d 762, 770 (La. Ct. App. 2003); Pro-Boll Chem. & Fertilizer Co. v. U.S. Fire & Guar. Co., 2004 U.S. Dist. LEXIS 28555, at *24–25 (W.D. La. Sept. 10, 2004).

110. No. 09-8071, 2010 WL 1222273 (La. Civ. Dist. Ct. Mar. 22, 2010).

111. 715 F. Supp. 2d 699 (E.D. Va. 2010).

112. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, MDL No. 2047, 2010 U.S. Dist. LEXIS 133497 (E.D. La. Dec. 16, 2010). Although another decision was issued recently by a Louisiana court in a first-party claim for damages from defective and corrosive drywall, the court in that case provided no analysis in granting the insurer's motion for summary judgment, and therefore the decision provides no guidance. *See* Ross v. C. Adams Constr. & Design, L.L.C., No. 676–185 (La. Dist. Ct. Apr. 14, 2010), *appeal docketed*, No. 10-CA-852 (La. App. Ct. Oct. 5, 2010).

113. *Finger*, 2010 WL 1222273, ¶¶ 1–5.

114. *Id*. ¶ 5.

115. *Id*. ¶ 30.

116. *Id*. ¶ 19.

117. *Id*. (citing Doerr v. Mobil Oil Corp., 774 So. 2d 119, 134 (La. 2000); State Farm Fire Ins. Co. v. MLT Constr. Co., 849 So. 2d 762, 770 (La. Ct. App. 2003)).

authority, the *Finger* court noted that the Louisiana Department of Insurance has determined that a "pollution incident" under a pollution exclusion in a first-party property policy refers only to an incident that causes "environmental damage."[118] The *Finger* court then found that the fact that Chinese drywall releases various gases into the structure is not "sufficient to qualify as a 'pollutant' under the policy's pollution exclusion."[119] The *Finger* court also noted that the insurer "acknowledged in its response to the insureds' motion for partial summary judgment that the 'pollution exclusion' was inapplicable and amended its answer" to remove its coverage defense based on the pollution exclusion.[120] For those reasons, the *Finger* court held that the insurer's affirmative defense based on the policy's pollution exclusion must be stricken.

Similarly, the court in the multidistrict litigation held, after application of the three *Doerr* considerations, that the pollution and/or contamination exclusions in the homeowners policies did not apply.[121] The court found that "whether the Chinese drywall is a pollutant is at best factually determinative and not a clear legal question" since Chinese drywall is not a "typical pollutant," although the elemental sulfur contained in and released by the Chinese drywall "may be considered a pollutant."[122] The court stated:

> The presence of Chinese drywall in the Plaintiffs' homes is outside the ambit of the Louisiana Supreme Court's concern with and focus upon environmental pollution for purposes of the exclusion. The Plaintiffs are not polluters, nor does Chinese drywall cause environmental pollution by its presence in the Plaintiffs' homes.[123]

In contrast, the court in the *Ward* case held that "under Virginia law, pollution exclusions are not limited to 'traditional environmental pollution.'"[124] The court found that while the defective and corrosive drywall itself may not have been a pollutant, the sulfur gases released by the defective and corrosive drywall constituted a pollutant under state and federal law and within the insurance policy's definition of a "pollutant," which included "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."[125]

118. *Id.*
119. *Id.* ¶ 20 (citing *Doerr*, 774 So. 2d at 134).
120. *Id.*
121. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, MDL No. 2047, 2010 U.S. Dist. LEXIS 133497, at *46 (E.D. La. Dec. 16, 2010).
122. *Id.* at *48–49.
123. *Id.* at *50–51.
124. Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 717 (E.D. Va. 2010).
125. *Id.*

The court then held that the undisputed dispersal and discharge of the sulfur gases from the defective and corrosive drywall constituted a "[d]ischarge, dispersal, seepage, migration, release or escape of pollutants" within the meaning of the pollution exclusion.[126] For those reasons, the *Ward* court held that the pollution exclusion applied to bar coverage under the first-party property policy for the loss.[127]

These three recent cases illustrate the opposing approaches among jurisdictions in interpreting the pollution exclusion contained in first-party property policies. Whether the pollution exclusion is likely to apply in a first-party claim for damages caused by defective and corrosive drywall will depend on whether the jurisdiction finds that the pollution exclusion unambiguously bars coverage for all injuries caused by contaminants or whether the pollution exclusion must be applied narrowly to damages caused only by traditional environmental pollution.

2. Corrosion Exclusion

Many first-party property policies state that they do not provide coverage for loss caused by "rust or other corrosion."[128] Most courts analyzing first-party claims have held that the corrosion exclusion is not ambiguous and applies to preclude most claims for damages caused by corrosion. For example, in *Bettigole v. American Employers Insurance Co.*,[129] the court found that the insured's claim for damages to a parking deck caused by gradual corrosion of the metal supports was barred by the all-risk policy's exclusion for corrosion.[130] In *Central International Co. v. Kemper National Insurance Cos.*,[131] the court found that steel coils that became rusted and corroded in transit were not covered under an all-risk policy because the policy's rust and corrosion exclusion barred coverage.[132] In *Resorts International, Inc. v. American Home Assurance Co.*,[133] the court held that the policy's corrosion exclusion barred a claim for air-conditioning failures that were the result of corrosion.[134] The court in *Gilbane Building Co. v. Altman Co.*[135] held that the "rust and corrosion exclusion" in a builders risk policy ex-

126. *Id.* at 717–18.
127. *Id.*
128. *See, e.g.*, Miller & Lefebvre, *supra* note 22, at 207 § I.A.2.c.6.c (Form HO00031000), 470.4 § B.2.d.2 (Form CP10301000), 503.8 § I.B.2.l.2 (Form BP00030106).
129. 567 N.E.2d 1259 (Mass. App. Ct. 1991).
130. *Id.* at 1260–61.
131. 202 F.3d 372 (1st Cir. 2000).
132. *Id.* at 376.
133. 311 So. 2d 806 (Fla. Dist. Ct. App. 1975).
134. *Id.* at 807.
135. 2005 WL 534906 (Ohio Ct. App. Mar. 8, 2005).

cluded coverage for corrosion and rust on metal surfaces caused by vapor from muriatic acid that was used to etch a concrete floor.[136] In *Arkwright-Boston Manufacturers Mutual Insurance Co. v. Wausau Paper Mills Co.*,[137] the court found that an all-risk policy did not cover a claim to recover the cost of repairing a reactor that was damaged by "sulfuric acid forming in the reactor and condensing on the steel shell" because the damage to the reactor was "'corrosion' within the ordinary meaning of the word" and the corrosion that caused the damage was exactly "the type of corrosion [that] the policy intended to exclude."[138] Likewise, in *Brodkin v. State Farm Fire & Casualty Co.*,[139] the court found that corrosion damage to the foundation of a house was not covered under the policy because it was "precisely the type of loss the exclusion was meant to cover."[140] Finally, in *80 Broad Street Co. v. United States Fire Insurance Co.*,[141] the court found that a claim for buckling of the marble facing of a building was excluded from coverage because the buckling was caused by rust and corrosion within the meaning of the policy's rust and corrosion exclusion.[142]

It appears that the only case in which a court has held that a corrosion exclusion did not apply to a first-party claim for damages caused by corrosion to metal objects is the recent *Finger* case.[143] There, the policy contained a "gradual or sudden loss" exclusion, which provided that "[w]e do not cover any loss caused by gradual deterioration, wet or dry rot, warping, smog, rust or other corrosion."[144] The *Finger* court found that the exclusion was designed to exclude only expected losses and that coverage is required because the policy is intended to protect "against accidents which may happen, not events which must happen."[145] The *Finger* court held that the policy's "gradual or sudden loss" exclusion was written to apply only where corrosion and rust were the cause of the property damage, and therefore did not apply because the corrosion caused by the sulfurous gases to the metal objects in the home was the damage.[146] The *Finger* court then struck the insurer's affirmative defense based upon the rust and corrosion portion of the "gradual or sudden loss" exclusion.

136. *Id.* at *6.
137. 818 F.2d 591 (7th Cir. 1987).
138. *Id.* at 596.
139. 265 Cal. Rptr. 710, 714 (Ct. App. 1989).
140. *Id.*
141. 389 N.Y.S.2d 214 (Sup. Ct. 1975).
142. *Id.* at 216.
143. Finger v. Audubon, 2010 WL 1222273 (La. Civ. Dist. Ct. Mar. 22, 2010).
144. *Id.* ¶ 21.
145. *Id.* ¶ 22 (citing Boudreaux v. Verret, 422 So. 2d 1167, 1172 (La. Ct. App. 1982); Gulf Transp. Co. v. Fireman's Fund Ins. Co., 83 So. 730, 733 (Miss. 1920)).
146. *Id.* ¶¶ 23–24.

Although one other Louisiana case holds that a corrosion exclusion is not applicable where the damage consists of corrosion instead of corrosion causing the damage in the context of a third-party claim,[147] the decision in *Finger* appears to fly in the face of all other decisions interpreting the corrosion exclusion, including other Louisiana decisions.[148]

The *Finger* decision also conflicts with two opinions recently rendered by Judge Fallon in the multidistrict litigation case of *In re Chinese-Manufactured Drywall Product Liability Litigation*.[149] In the April 27, 2010, multidistrict litigation decision, the court found that the sulfur gases emitted by the Chinese drywall proximately caused corrosion on metal components throughout the Hernandez house.[150] The court further found that the corrosion on the metal increased resistance of electrical current through the connection, causing complete failure or excessive heating of the connection when energized and leading to premature failure of the product and the likelihood of fire and other life safety problems.[151] In other words, the court found that corrosion caused the damage.[152]

Likewise, in the December 16, 2010, decision in the multidistrict litigation, the court found that the insureds' allegations that Chinese drywall emitted gases that caused corrosion to metallic and electrical components in the houses triggered the homeowners policies' corrosion exclusions because "corrosion is responsible for the majority of the losses suffered by the Plaintiffs."[153] The court then cited *Ward* and other decisions, holding that corrosion exclusions preclude coverage for corrosion, whether corrosion is the loss or whether corrosion causes the loss.[154]

The *Finger* decision also conflicts with the recent holding in the *Ward* case.[155] In *Ward*, the court held that the policy's exclusion for "rust or other

147. *See* Trus Joist Macmillan v. Neeb Kearney & Co., 2000 U.S. Dist. LEXIS 3852, at *7 (E.D. La. Mar. 23, 2000).

148. *Compare* Central Louisiana Elec. Co., Inc. v. Westinghouse Elec. Corp., 579 So. 2d 981 (La. 1991) (policy exclusion for corrosion precluded coverage for all damage since cracking of turbine blade unit was caused by corrosion); Transcon. Ins. Co. v. Guico Mach. Works, 2008 U.S. Dist. LEXIS 69972, at *4 (E.D. La. Sept. 17, 2008) (policy's exclusion for "loss or damage caused by or resulting from rust" excluded all loss from rust); Orthopedic Practice, LLC v. Hartford Cas. Ins. Co., 2008 U.S. Dist. LEXIS 18335, at *8 (E.D. La. Mar. 10, 2008) (rust damage excluded under rust exclusion because terms of policy were clear and explicit, and therefore must be enforced as written).

149. MDL No. 2047, 2010 U.S. Dist. LEXIS 41190 (E.D. La. Apr. 27, 2010); MDL No. 2047, 2010 U.S. Dist. LEXIS 133497 (E.D. La. Dec. 16, 2010).

150. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, 2010 U.S. Dist. LEXIS 41190, at *22–23.

151. *Id* at *23–24.

152. *Id*. at *26–27.

153. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, 2010 U.S. Dist. LEXIS 133497, at *65.

154. *Id*. at *66–68.

155. Travco Ins. Co. v. Ward, 715 F. Supp. 2d (E.D. Va. 2010), *appeal docketed*, No. 10-1710 (4th Cir. June 24, 2010).

corrosion" precluded coverage for the claimed losses to the structural, mechanical, and plumbing components of the residence.[156] The court noted that "[m]ost jurisdictions hold that an exclusion for damages caused by corrosion precludes recovery for damages caused by corrosion regardless of what caused the corrosion or how suddenly the corrosion occurred."[157] Since "it [was] undisputed that the damage to the 'structural, mechanical and plumbing systems' of the . . . residence was caused by the 'action or process of corroding,' the corrosion exclusion unambiguously applie[d]."[158]

Notwithstanding the recent *Finger* decision, it appears likely that most courts will interpret the corrosion exclusion as the courts did in the recent decisions in *Ward* and the multidistrict litigation to preclude coverage for damages caused by defective or corrosive drywall, since the majority of jurisdictions have held that corrosion exclusions apply to claims for damages caused by corrosion.

3. Exclusion for Faulty, Inadequate, or Defective Construction or Materials

First-party property policies also typically include exclusions for faulty, inadequate, or defective construction or materials, which generally state that no coverage is provided for faulty, inadequate, or defective "design, specifications, workmanship, repair, construction, renovation, remodeling, grading, or compaction," or for faulty, inadequate, or defective "materials used in repair, construction, renovation or remodeling."[159]

Most courts have held that "faulty workmanship" exclusions in all-risk policies are unambiguous.[160] Generally, exclusions for faulty, inadequate, or defective construction or materials are interpreted as excluding coverage for damage resulting from faulty or defective materials or from faulty installation during construction, but not excluding coverage for damage caused by negligent practices of the contractor during the construction process.[161]

Indeed, as a general rule, exclusions for faulty, inadequate, or defective construction or materials exclude coverage for the quality of the product

156. *Id*. at 715.
157. *Id*. at 714.
158. *Id*. (citation omitted).
159. *See*, *e.g*., Miller & Lefebvre, *supra* note 22, at 212 § I.B.3.b (Form HO00031000), 470.5 § B.3.c (Form CP10301000), 503.9 § I.B.3.c (Form BP00030106).
160. *See*, *e.g*., Schultz v. Erie Ins. Group, 754 N.E.2d 971, 977 (Ind. Ct. App. 2001); L.F. Driscoll Co. v. Am. Prot. Ins. Co., 930 F. Supp. 184, 187 (E.D. Pa. 1996); McDonald v. State Farm Fire & Cas. Co., 837 P.2d 1000, 1005 (Wash. 1992); Brodkin v. State Farm Fire & Cas. Co., 265 Cal. Rptr. 710, 714 (Ct. App. 1989); Kroll Constr. Co. v. Great Am. Ins. Co., 594 F. Supp. 304, 306 (N.D. Ga. 1984).
161. *See supra* note 160.

but do not exclude coverage for damage to the product caused by negligence during the construction period.[162] For example, in *Federated Department Stores, Inc. v. M.J. Clark, Inc.*,[163] the court held that the "faulty workmanship" exclusion did not apply where the damage resulted from negligence during construction.[164] Similarly, in *Otis Elevator Co. v. Civil Factory Mutual Insurance Co*.[165] the court found that the faulty workmanship exclusion did not apply where the damage "result[ed] from subcontractor negligence unrelated to the quality of any product or process."[166] In addition, the court in *City of Burlington v. Hartford Steam Boiler Inspection & Insurance Co*.[167] held that the plain language of the exclusion for "errors in design, faulty workmanship or use of faulty materials" precluded coverage for damages caused by faulty materials or faulty installation of a pipe but not damages resulting from subcontractor negligence in the repair and maintenance of the pipe.[168]

Numerous courts have held that the exclusion for faulty, inadequate, or defective construction or materials "includes losses caused by defects in the design and construction of a building."[169] Therefore, an exclusion for faulty, inadequate, or defective construction or materials may be applicable in cases involving defective and corrosive drywall since it is a defect in the drywall itself that causes the damage.

However, in the recent *Finger* decision, the court found that the defective drywall did not fall within the meaning of the policy's "faulty, inadequate or defective planning" exclusion because the defects in the drywall did not "render[] the drywall unable to perform the purpose of drywall" itself.[170] As a result, the court struck the insurer's affirmative defense based on the "faulty, inadequate or defective planning" exclusion.[171]

The *Finger* court cited no authority for its conclusion that the "faulty, inadequate or defective planning" exclusion did not apply because defects

162. *See, e.g.*, Barre v. N.H. Ins. Co., 396 A.2d 121, 123 (Vt. 1978).
163. No. 4 C 879, 2007 U.S. Dist. LEXIS 51826 (N.D. Ill. July 17, 2007).
164. *Id.* at *14–15.
165. 353 F. Supp. 2d 274 (D. Conn. 2005).
166. *Id.* at 281–82.
167. 190 F. Supp. 2d 663 (D. Vt. 2002).
168. *Id.* at 672.
169. *See, e.g.*, Fu-Kong Tzung v. State Farm Fire & Cas. Co., 873 F.2d 1338, 1341 (9th Cir. 1989) (cracks in drywall, driveway, and building slab); *see also* L.F. Driscoll Co. v. Am. Prot. Ins. Co., 930 F. Supp. 184, 187 (E.D. Pa. 1996) (damaged and leaking roofs on hospital); Ryan Homes v. Home Indem., 647 A.2d 939, 944 (Pa. Super. Ct. 1994) (defective plywood causing loss of structural strength in roofs); McDonald v. State Farm Fire & Cas. Co., 837 P.2d 1000, 1006 (Wash. 1992) (cracked house foundation); Kroll Constr. Co. v. Great Am. Ins. Co., 594 F. Supp. 304, 307 (N.D. Ga. 1984) (deficient waterproofing on exterior of office building).
170. Finger v. Audubon, 2010 WL 1222273, ¶ 28 (La. Civ. Dist. Ct. Mar. 22, 2010).
171. *Id.*

in the drywall did not prevent the drywall from functioning as drywall.[172] While it is true that the defective and corrosive drywall appeared to retain its structural integrity, the *Finger* court failed to consider that the defective and corrosive drywall prevented people from occupying the structure and created life safety risks such as an increased risk of fire from the failure of damaged electrical wiring and appliances. These factors called into question the fitness of the defective and corrosive drywall to be used as drywall.

The fitness of defective and corrosive drywall for use as drywall in structures was considered specifically by the court in *Ward*. The *Ward* court found that, "[a]lthough the [defective and corrosive] [d]rywall ha[d] not collapsed or otherwise physically deteriorated, it [was] certainly not serving its purpose as a component of a livable residence."[173] The *Ward* court noted that "[c]onsistent with the ordinary meaning of the words 'faulty' and 'defective,' courts have held that the faulty materials exclusion can apply even when the property in question may be serving its intended purpose."[174] The *Ward* court further noted that the only contrary authority appears to be the *Finger* decision, which the *Ward* court specifically declined to follow because "the *Finger* court cited no authority in support of its holding" and because "[t]he clear weight of authority stands against *Finger* and supports the application of the faulty material exclusion."[175]

As in *Ward*, the court's recent decision in the multidistrict litigation likewise declined to follow the *Finger* decision because "*Finger* failed to provide an explanation as to how it came to define faulty materials, only citing conclusions reached in the plaintiff's own memorandum and testimony, and the testimony of the insurer's corporate representative."[176] The court held that the Chinese-manufactured drywall contained in the insureds' homes constituted "faulty materials," and therefore held that the losses were excluded from coverage by the policies' faulty materials exclusions.[177]

While it is possible that other courts could follow the *Finger* decision, it is more likely that most courts will follow the decisions in *Ward* and the multidistrict litigation in holding that an exclusion for faulty, inadequate, or defective construction or materials applies to bar coverage for first-party property claims for damages caused by defective and corrosive drywall because a defect in the drywall caused the damage.

172. *Id*.
173. Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 715 (E.D. Va. 2010).
174. *Id*.
175. *Id*.
176. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, MDL No. 2047, 2010 U.S. Dist. LEXIS 133497, at *57 (E.D. La. Dec. 16, 2010).
177. *Id*. at *59–60.

4. Inherent Vice or Latent Defect Exclusion

Finally, many first-party property policies contain an exclusion that precludes coverage for loss caused by "inherent vice" or "latent defect."[178] The courts have explained that the term "inherent vice" does not relate to an extraneous cause, but instead means a loss caused entirely by some quality within the property for which recovery is sought that brings about its own injury or destruction.[179] In addition, the term "latent defect" has been interpreted by courts to mean a hidden or concealed defect that is not apparent and would not be discoverable upon reasonable inspection.[180] Improper construction has been held by various courts to be an "inherent vice" or "latent defect" within the meaning of the exclusion.[181]

The *Finger* court addressed whether losses caused by defective and corrosive drywall fall within the exclusion for inherent vice or latent defect. The *Finger* court found that the policy's "gradual or sudden loss" exclusion, which provided that "[w]e do not cover any loss caused by gradual deterioration, wet or dry rot, warping, smog, rust or other corrosion," included losses caused by an "inherent vice" or "latent defect."[182] The court ruled, however, that the exclusion applied only to "loss[es] due to any quality in the property that cause[d] [it] to damage or destroy itself" and therefore

178. *See*, *e.g.*, Miller & Lefebvre, *supra* note 22, at 470.4 § B.2.d.2 (Form CP10301000), 503.8 § I.B.2.l.2 (Form BP00030106).

179. *See*, *e.g.*, Am. Home Assurance Co. v. J.F. Shea Co., 445 F. Supp. 365, 368 (D.D.C. 1978); Emp'rs Cas. Co. v. Holm, 393 S.W.2d 363, 367 (Tex. Civ. App. 1965).

180. *See*, *e.g.*, Alexander v. Suncoast Builders, Inc., 837 So. 2d 1056, 1058 (Fla. Dist. Ct. App. 2002); Nida v. State Farm Fire & Cas. Co., 454 So. 2d 328, 335 (La. Ct. App. 1984); Walker v. Travelers Indem. Co., 289 So. 2d 864, 870 (La. Ct. App. 1974); Reliance Ins. Co. v. Brickenkamp, 147 So. 2d 200, 202 (Fla. Dist. Ct. App. 1962); Reisman v. N.H. Fire Ins. Co., 312 F.2d 17, 20 (5th Cir. 1963); Glens Falls Ins. Co. v. Long, 77 S.E.2d 457, 459 (Va. 1953).

181. *See*, *e.g.*, Church of the Palms-Presbyterian (U.S.A.), Inc. v. Cincinnati Ins. Co., 404 F. Supp. 2d 1339, 1343 (M.D. Fla. 2005) (loss stemming from defective construction not covered due to latent defect exclusion); Chubb Group of Ins. Cos. v. Guyuron, 1995 Ohio App. LEXIS 5512, at *14–15 (1995) (negligent design and construction fell under latent defect exclusion because defects only discoverable upon excavation, and therefore were not readily discoverable); Fu-Kong Tzung v. State Farm Fire & Cas. Co., 873 F.2d 1338, 1342 (9th Cir. 1989) (coverage precluded by exclusion for latent defect where deficiencies in design of apartment building were hidden in ground and therefore not readily discoverable); Nida v. State Farm Fire & Cas. Co., 454 So. 2d 328, 335 (La. Ct. App. 1984) (defect in construction of foundation was an inherent vice or latent defect within meaning of policy exclusion); Luttenberger v. Allstate Ins., 470 N.Y.S.2d 988, 989 (Dist. Ct. 1984) (faulty construction of eaves was excluded as latent defect); 80 Broad Street Co. v. U.S. Fire Ins. Co., 389 N.Y.S.2d 214, 216 (Sup. Ct. 1975) (loss caused by improper construction of marble façade was excluded as latent defect); Plaza Equities Corp. v. Aetna Cas. & Sur. Co., 372 F. Supp. 1325, 1331 (S.D.N.Y. 1974) (defective design that failed to include sufficient supporting columns fell within exclusion).

182. Finger v. Audubon, 2010 WL 1222273, ¶ 25 (La. Civ. Dist. Ct. Mar. 22, 2010).

did not apply because there was "no evidence that the [defective] drywall [was] damaging or destroying itself."[183]

The *Ward* court reached the opposite conclusion. In applying the property policy's exclusion for "latent defect, inherent vice, or any quality that causes it to damage or destroy itself," the *Ward* court noted that in the Fourth Circuit, a latent defect must be "integral to the damaged property by reason of *its* design or manufacture or construction."[184] The *Ward* court quoted the Fourth Circuit's unpublished decision in *U.S. West v. Aetna Casualty & Surety Co*., in which the court found that only those defects "which are not readily discoverable that also are integral to the damaged property's design or manufacture or construction" are "latent defects" within the meaning of the exclusion.[185] The *Ward* court held that, in light of the *U.S. West* case, the owner's claims for damage to the air conditioner and garage door were not excluded because the alleged damage was not caused by a latent defect within the meaning of the policy exclusion since "there [was] no indication that the air conditioner or the garage door were manufactured or constructed in a defective manner."[186]

However, the *Ward* court held that the owner's claim for the cost of removing and replacing the defective and corrosive drywall was excluded by the property policy's latent defect exclusion.[187] The court explained:

> Defendant's claim for the cost of removing and replacing the Chinese Drywall presents a more difficult question. In a certain sense, the Drywall is not "damaged property" at all, and thus its defects cannot be latent defects within the meaning of *U.S. West*. But Defendant cannot argue that he has suffered a "direct physical loss" within the meaning of the Policy, and then turn around and claim that the relevant property remains in an undamaged state. As discussed above, Defendant's claim is for the damages to the Ward Residence. There is no question that the Ward Residence suffers from defects "that . . . are integral to the damaged property's design or manufacture or construction." *U.S. West*, 117 F. 3d 1415. Specifically, the Ward Residence contains defective Drywall that is off-gassing and damaging other components of the Residence. The Drywall is plainly integral to the Residence's manufacture and construction. Accordingly, the Court finds that the damage to the Ward Residence is a loss caused by a latent defect.[188]

183. *Id*.
184. Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 710 (E.D. Va. 2010) (emphasis in original).
185. *Id*. at 711 (quoting U.S. West v. Aetna Cas. & Sur. Co., 1997 U.S. App. LEXIS 17747, at *14 (4th Cir. 1997) (table)).
186. *Id*.
187. *Id*. at 712.
188. *Id*. at 711.

The *Ward* court noted that the court in *Finger* had found that the latent defect exclusion was not applicable "under strikingly similar facts" but distinguished the *Finger* decision as "unpersuasive" because "there is an inherent contradiction in arguing that property has suffered a 'direct physical loss" while simultaneously maintaining that the property is not damaged."[189] The *Ward* court also noted that, under *U.S. West* and other Fourth Circuit precedent, "it is sufficient that the defect be 'integral" to the damaged property; it is not necessary to show that the defect is coextensive with the damaged property."[190] Finally, the *Ward* court noted that "another Louisiana district court . . . ruled contrary to *Finger* and granted summary judgment to an insurer on facts similar to the case at hand."[191] The *Ward* court then held that the owner's claim for "the cost of removing and replacing the [defective and corrosive] [d]rywall [was] excluded by the [property] [p]olicy's latent defect exclusion."[192]

The court's recent decision in the multidistrict litigation considered both the *Finger* and the *Ward* cases, noting that they were "factually on point with the present motions" but "employ different legal precepts and reach diametrically opposed conclusions."[193] The court found that "whether or not the latent defect exclusion applies to the present cases is a close call" considering that Louisiana law requires that a defect be hidden and not discoverable upon a reasonable, customary inspection or test, but the plaintiffs were not aware that their homes contained Chinese-manufactured drywall and that the damages were caused by the drywall until they learned of the problem from the media or other sources.[194] Ultimately, the court could not "make a definitive determination as to whether the damage caused by the Chinese drywall in the Plaintiffs' homes constitutes a latent defect."[195] The court held that the insurers had not met their burden of showing the applicability of the latent defect exclusion and therefore held that the exclusion was not applicable.[196]

It is unclear how other courts will apply the "inherent vice" or "latent defect" exclusion to first-party property claims arising out of defective and

189. *Id*. at 712.
190. *Id*.
191. *Id*. (citing Ross v. C. Adams Constr. & Design, L.L.C., No. 676-185 (La. Dist. Ct. Apr. 14, 2010), *appeal pending*). It is not clear how the *Ward* court utilized the *Ross* decision as persuasive authority since that decision did not specify the grounds upon which summary judgment was granted to the insurer.
192. *Id*.
193. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, MDL No. 2047, 2010 U.S. Dist. LEXIS 133497 at *31–32 (E.D. La. Dec. 16, 2010).
194. *Id*. at *35 (*citing* Nida v. State Farm Fire & Cas. Co., 454 So. 2d 328, 335 (La. Ct. App. 1984)).
195. *Id*. at *38.
196. *Id*.

corrosive drywall. Some courts may agree with the *Finger* court that the exclusion does not apply because the defective and corrosive drywall has not destroyed itself, but instead has caused damage to other property. Other courts may agree with the *Ward* court in holding that the exclusion is applicable to claims for the cost of removing or replacing the defective and corrosive drywall, although not applicable to claims for damage to other property resulting from the drywall, because the drywall is integral to the construction and design of the structure. The determining factor in applying the "inherent vice" or "latent defect" exclusion will be whether a court finds that the damage for which coverage is sought arises out of a quality in the property itself that brings about its own destruction.

D. *Ensuing Loss Exception to Policy Exclusions*

In most first-party property policies, the policy's exclusions contain an exception for "ensuing loss." These exceptions typically provide that any ensuing loss either caused by a covered cause of loss or not excluded by any other provision in the policy is covered under the policy.[197]

In general, "[a]n exception to an exclusion cannot create coverage where none exists."[198] Rather, an exception to an exclusion operates to restore coverage if the damage ensues from a covered cause of loss.[199] In the context of property insurance policy exclusions, "courts generally recognize that a 'resulting loss' or 'ensuing loss' exception to a policy exclusion does not operate to resurrect coverage for the excluded loss, but rather works to reaffirm coverage for secondary, wholly separate and independent losses which arise out of an excluded peril."[200]

Most courts hold that, when reasonably interpreted, the ensuing loss clause means that if there is a subsequent ensuing loss that is separate and independent from the initial excluded loss, the subsequent ensuing cause is covered.[201] However, other courts have held that secondary losses can be

197. *See*, *e.g.*, Miller & Lefebvre, *supra* note 22, at 212 § I.B (Form HO00031000), 470.5 § B.3 (Form CP10301000), 503.9 § I.B.3 (Form BP00030106).

198. Hartford Cas. Ins. Co. v. Evansville Vanderburgh Pub. Library, 860 N.E.2d 636, 646 (Ind. Ct. App. 2007) (citation omitted); *see also* Wright v. Safeco Ins. Co. of Am., 109 P.3d 1, 7 (Wash. Ct. App. 2004).

199. *See* Weeks v. Coop. Ins. Cos., 817 A.2d 292, 296 (N.H. 2003).

200. *See*, *e.g.*, RTG Furniture Corp. v. Indus. Risk Insurers, 616 F. Supp. 2d 1258, 1265 (S.D. Fla. 2008); Cooper v. Am. Family Mut. Ins. Co., 184 F. Supp. 2d 960, 964 (D. Ariz. 2002); *see also* Swire Pac. Holdings, Inc. v. Zurich Ins. Co., 139 F. Supp. 2d 1374, 1380 (S.D. Fla. 2001); Prudential Prop. & Cas. Ins. Co. v. Lillard-Roberts, 2002 U.S. Dist. LEXIS 20387, at *59–60 (D. Or. June 18, 2002).

201. *See*, *e.g.*, GTE Corp. v. Allendale Mut. Ins. Co., 372 F.3d 598, 613–14 (3d Cir. 2004) (cost of correcting design defects not covered as ensuing loss); Wright v. Safeco Ins. Co. of Am., 109 P.3d 1, 7 (Wash. Ct. App. 2004) (mold damage not covered as ensuing loss because caused by faulty construction work); *Swire Pac. Holdings, Inc.*, 845 So. 2d at 161 (cost to repair

covered as an ensuing loss even where there is no separate and independent cause.[202]

In the recent *Ward* case, the court followed the majority of courts in holding that the policy's ensuing loss exception did not apply to a claim for damage due to the installation of Chinese drywall.[203] The court found that the property policy's ensuing loss provisions provided coverage only for a loss if three conditions were met: (1) the loss was "ensuing," (2) the loss was not "'excluded by any other provision' in the policy," and (3) "if the loss ensue[d] from an original loss excluded by the latent defect, corrosion, or pollutant exclusion, the loss must [have] be[en] a loss to 'property described in Coverages A and B.'"[204] The court found that the policy's ensuing loss provisions did not apply because none of the losses were "ensuing" losses, since the release of sulfur gases from the defective and corrosive drywall over a period of time constituted only "a single discrete loss from a single discrete injury."[205] The *Ward* court then held that even if the losses had been ensuing losses, they still would be losses excluded by the policy's corrosion exclusion.[206] Although the court held that the ensuing loss provision did not apply to any of the owners' currently claimed losses, the court noted that other losses could potentially be claimed in the future

physical loss caused by design defect not covered under ensuing loss exception because no loss separate from design defect occurred); *Lillard-Roberts*, 2002 U.S. Dist. LEXIS 20387, at *61–62 (mold damage not covered as ensuing loss because no intervening cause after excluded water damage); Alton Ochsner Med. Found. v. Allendale Mut. Ins. Co., 219 F.3d 501, 506 (5th Cir. 2000) (no coverage for cracking damage to parking deck under ensuing loss exception because no separate cause of loss from defective construction); Narob Dev. Corp. v. Ins. Co. of N. Am., 631 N.Y.S.2d 155, 156 (App. Div. 1995) (collapse of wall caused by defective workmanship not covered because ensuing loss directly related to original excluded risk); Acme Galvanizing Co. v. Fireman's Fund Ins. Co., 270 Cal. Rptr. 405, 411 (Ct. App. 1990) (damage to equipment caused by molten zinc not covered as ensuing loss because no separate cause from latent defect).

202. *See*, *e.g.*, Eckstein v. Cincinnati Ins. Co., 469 F. Supp. 2d 444, 454–55 (W.D. Ky. 2007) (mold damage resulting from faulty construction that allowed water infiltration covered as ensuing loss); Arnold v. Cincinnati Ins. Co., 688 N.W.2d 708, 719 (Wis. Ct. App. 2004) (coverage under ensuing loss provision for claim for water damage to interior of house caused by rain leaking through damaged caulking around windows resulting from faulty workmanship and materials); Dawson Farms, L.L.C. v. Millers Mut. Fire Ins. Co., 794 So. 2d 949, 952–53 (La. Ct. App. 2001) (damage to stored sweet potatoes caused by condensation from faulty construction covered as ensuing loss); Blaine Constr. Corp. v. Ins. Co. of N. Am., 171 F.3d 343, 353–54 (6th Cir. 1999) (ensuing loss exception provided coverage for water damage to ceiling insulation resulting from faulty workmanship); Lake Charles Harbor & Terminal Dist. v. Imperial Cas. & Indem. Co., 857 F.2d 286, 288 (5th Cir. 1988) (damage to ship loader caused by mechanical failure of cable covered under policy's ensuing loss exception).

203. Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 720 (E.D. Va. 2010).

204. *Id*. at 718.

205. *Id*. at 718–19.

206. *Id*. at 719–20.

that might be covered by the policy's ensuing loss provision, but declined to express "an opinion on whether the provision might apply to other as-yet-unclaimed losses."[207]

Similarly, the court in the recent multidistrict litigation also held that the policies' ensuing loss exception did not apply to the insureds' claims for damage from Chinese drywall.[208] The court noted that neither the insurance policies nor the Louisiana Supreme Court had provided a definition of ensuing loss.[209] However, based on decisions from the Louisiana appellate courts and the Fifth Circuit, the court summarized three principles for analyzing ensuing losses: (1) damage that falls under the ensuing loss provision must be different in kind from the original damage; (2) the mere fact that an excluded event is the "but for" cause of the ensuing loss does not necessarily preclude coverage for the ensuing loss; and (3) damage arising from faulty workmanship during the construction process is distinguishable from damage caused by events extraneous to the construction process.[210] The court found that losses caused by odors emitted from the Chinese drywall were not ensuing losses because "they are neither sufficiently different in kind from the losses caused by the Chinese drywall, nor the result of an extraneous event."[211] The court also found that the corrosion-related losses caused by Chinese drywall did not constitute ensuing losses, but that even if they did, they would remain excluded losses because of the policies' corrosion exclusion.[212] The court concluded that the policies' ensuing loss provisions did not apply because no ensuing losses had been alleged by the insureds, but the court declined to foreclose any future Chinese drywall-related ensuing loss claims under homeowners insurance policies.[213]

Most courts likely will hold that the ensuing loss exception does not apply to a first-party claim for property damage caused by defective and corrosive drywall, as the courts held in the recent *Ward* and the multidistrict litigation cases, because the damage was not caused by a separate and independent cause of loss, which most jurisdictions require to apply the ensuing loss exception. However, in jurisdictions that hold that secondary losses can be covered as an ensuing loss even where there is no separate and independent cause, courts may hold that the ensuing loss exception

207. *Id*. at 720.
208. *In re Chinese-Manufactured Drywall Prod. Liab. Litig.*, MDL No. 2047, 2010 U.S. Dist. LEXIS 133497, at *77 (E.D. La. Dec. 16, 2010).
209. *Id*. at *70.
210. *Id*. at *72–73 (quoting Holden v. Connex-Metalna, 2000 U.S. Dist. LEXIS 18359, at *6 (E.D. La. Dec. 12, 2000)).
211. *Id*. at *74.
212. *Id*. at *75.
213. *Id*. at *77.

does apply to first-party claims for property damage caused by defective and corrosive drywall.

III. CONCLUSION

Lawsuits involving first-party claims by property owners for damages resulting from defective and corrosive drywall are destined to become more common as insureds seek to recover under their first-party property insurance policies for the extensive losses caused by such drywall. There is no question that damages caused by defective and corrosive drywall can constitute a "direct physical loss" under the terms of a property insurance policy. However, it appears that the policy exclusions for pollutants and contaminants, corrosion, and possibly defective construction or materials are likely to preclude coverage for the losses.

It is not entirely clear how most courts will apply the pollution exclusion to first-party claims for damages caused by defective and corrosive drywall, since the majority of case law involves third-party claims that deal with significantly different issues. However, other than Louisiana and the few other jurisdictions where courts have found that the pollution exclusion refers only to environmental damage, most courts have found that the pollution exclusion unambiguously bars coverage for all injuries caused by contaminants, and therefore should apply to claims for damages caused by defective and corrosive drywall.

Despite the recent *Finger* decision holding that the corrosion exclusion and the faulty workmanship and materials exclusion did not apply to the insureds' claims for damages caused by defective and corrosive drywall, most courts analyzing first-party claims have held that the corrosion exclusion and the faulty workmanship or materials exclusion in all-risk policies are not ambiguous and apply to most claims for damages caused by corrosion. Therefore, most courts likely will follow the recent decisions in *Ward* and the multidistrict litigation and find that the corrosion exclusion and the faulty workmanship or materials exclusion bar coverage under first-party property policies for damages caused by defective and corrosive drywall.

As with the pollution exclusion, it is unclear how most courts will apply the inherent vice or latent defect exclusion to first-party claims for damages caused by defective and corrosive drywall, although the determining factor will likely be whether a court finds that the damage for which coverage is sought arises out of a quality in the property itself that brings about its own destruction. Courts that find that the defective and corrosive drywall has not destroyed itself, but instead has caused damage to other property, probably will agree with the *Finger* court that the exclusion does not apply to bar coverage. However, other courts may find that the drywall is integral to the construction and design of the structure and therefore

hold that the exclusion applies to bar coverage, as in the decisions in *Ward* and the multidistrict litigation.

Finally, it is likely that most courts will agree with the decisions in *Ward* and the multidistrict litigation that held that the ensuing loss exception does not apply to a first-party claim for property damage caused by defective and corrosive drywall because the damage was not caused by a separate cause of loss, which most jurisdictions require to apply the ensuing loss exception. However, in jurisdictions that hold that secondary losses can be covered as an ensuing loss even where there is no separate and independent cause, courts may hold that the ensuing loss exception does apply to first-party claims for property damage caused by defective and corrosive drywall.

As a result of the problems caused by defective and corrosive drywall, many property owners will be left with virtually uninhabitable structures that require extensive renovation or even demolition. Unfortunately for those owners, first-party property insurance policies likely will not provide any assistance to most property owners because the policy exclusions for pollutants and contaminants, corrosion, and defective construction or materials generally will bar coverage for first-party claims to recover for the damages caused by defective and corrosive drywall.