

Louisiana Court Denies Applicability of Policy Exclusions in “Chinese Drywall” Claims

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In a recent decision regarding insurance coverage for claims related to allegedly defective “Chinese drywall,” a Louisiana court found that certain policy exclusions that have been routinely utilized by insurance companies as a basis to deny coverage to homeowners and drywall manufacturers were not applicable. *Finger et al. v. Audubon Insurance Company*, Case No. 09-0871 (La. Dist. Ct., Orleans Parish, Division D-16, Mar. 22, 2010). The decision by Judge Lloyd Medley of the Louisiana Civil District Court granted the homeowners’ motion to strike the insurer’s affirmative defenses based on three exclusions contained in the policy: “Pollution or Contamination,” “Gradual or Sudden Loss,” and “Faulty, Inadequate or Defective Planning.”

The Audubon policy “Pollution or Contamination” exclusion provided:

We do not cover any loss, directly or indirectly, regardless of any cause or event contributing concurrently or in any sequence to the loss, caused by the discharge, dispersal, seepage, migration or release or escape of pollutants. Nor do we cover the cost to extract pollutants from land or water, or the cost to remove, restore, or replace polluted or contaminated land or water. A “pollutant” is any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and “waste.” A “contaminant” is an impurity resulting from the mixture of or contact with a foreign substance. “Waste” includes materials to be disposed of, recycled, reconditioned or reclaimed.

Applying established Louisiana law and a prior decision by the State of Louisiana Commissioner of Insurance in interpreting the “all risk” insurance policy issued to the plaintiffs, the court found that the pollution exclusion “does not, and was never intended, to apply to residential homeowners claims for damages caused by substandard building materials.” Op. at 5. Prior to the motion to strike, Audubon had amended its answer to remove the pollution exclusion affirmative defense, but the court found that the exclusion remained “a part of the current case as a reason for Audubon’s denial of the Fingers’ claim,” and, therefore, subject to interpretation. Op. at 2. The court found that the “fact that Chinese drywall releases various gases into the home is not sufficient to qualify as a ‘pollutant’ under the pollution exclusion.” *Id.*

The court also found that the policy’s “Gradual or Sudden Loss” exclusion was inapplicable. The exclusion provided:

We do not cover any loss caused by gradual deterioration, wet or dry rot, warping, smog, rust or other corrosion. In addition, we do not cover any loss caused by inherent vice, wear and tear, mechanical breakdown or latent defect. However, we do insure ensuing covered loss unless another exclusion applies.

Audubon argued that the phrase “rust or other corrosion” barred coverage. Op. at 6. However, the court found that the “exclusion is intended to apply where corrosion, rust or the like is the cause of the property damage; it is not designed to preclude coverage where the rust or corrosion is the damage itself.” *Id.* The court rationalized that in the case at hand, “the corrosion caused to the metals in the Fingers’ home by the sulphurous gases released by the Chinese drywall is the loss, not the cause of the loss.” *Id.*

Under the same exclusion, Audubon argued that the “inherent vice” or “latent defect” language should operate to bar coverage. *Id.* The court rejected this argument, finding that the “inherent vice or latent defect exclusion applies to ‘a loss due to any quality in the property that causes property to damage or destroy itself that results from something within the property itself as opposed to some outside force.’” Op. at 6–7. The court noted that “[o]ne of the insidious characteristics of Chinese drywall is that, while it off-gases, it performs all of the expected functions of drywall, such as fire protection, sounds and heat insulation, holding paint on walls and allowing for hanging of picture frames and other wall mounted items.” Op. at 7.

The final exception that the court found did not apply to the plaintiffs’ claim for coverage was the “Faulty, Inadequate or Defective Planning” exclusion, which provided:

We do not cover any loss caused by faulty, inadequate or defective:

- a. Planning, zoning, development, surveying, siting;
 - b. Design, specifications, workmanship, repair, construction, renovation, remodeling, grading, compaction;
 - c. Materials used in repair, construction, renovation or remodeling, grading or compaction; or
 - d. Maintenance; of part or all of any property whether on or off the residence.
- However, we do insure ensuing covered loss unless another exclusion applies.

The court found this exclusion did not apply. According to the court, the Chinese drywall was not “defective” under the plain language of the policy because the “defect” is not one that “renders the drywall unable to perform the purpose of drywall.” Op. at 8. “Rather, the damage that the Chinese drywall causes is based upon a quality distinct” from the purpose of “an aesthetic or finishing material for a home.” *Id.*

The importance of this decision is twofold:

First, it highlights that insurance coverage issues are impacted by the laws of individual states, such that choice of law might be dispositive on an interpretive dispute. Louisiana has a history of interpreting the pollution exclusion in a way that is favorable to parties seeking coverage for Chinese drywall–related claims, while many other states do not. Insurers, recognizing the importance of forum selection, should use this information to determine the forum in which to sue their policyholders.

