



Chinese Drywall - Insurance Coverage Issues and Solutions

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A SHORT GUIDE FOR INSURANCE AGENTS AND BROKERS

Losses associated with Chinese drywall will affect thousands of property owners, “responsible parties” and their lenders. We anticipate new insurance needs and new sources of demand for environmental insurance products as a result. Insurance intermediaries with a working knowledge of the risk management issues associated with Chinese drywall and other indoor pollutants will enjoy a new source of revenue and will have a competitive advantage in their market sectors. Specially designed environmental insurance policies can cover the Chinese drywall loss exposure of most stakeholders. In contrast, traditional property and liability insurance policies will have significant coverage gaps for claims associated with Chinese drywall. ARMR.Net has developed a complete portfolio of custom crafted environmental insurance products to address the loss exposures associated with Chinese drywall plus a wide range of environmental loss exposures.

The Problem

In short, some but not all sources of Chinese drywall off-gas sulfide gas which combines with water vapor to create sulfuric acid vapor within the built environment. Most contaminated drywall was installed between 2006 and 2007 in at least twenty four and as many as forty one states. Some contaminated drywall may have been installed as early as 2002. The main source of the contamination is apparently the gypsum rock in China that was used to manufacture the drywall. The jury is literally out on the possible adverse health effects to the occupants of the contaminated buildings; these health affects do not appear to be acute. However it is clear that buildings containing sulfur contaminated drywall, which can smell like rotten eggs or burnt match's will need to be remediated. Remediation involves removing the drywall and other porous surfaces, assessing and correcting potential structural damage, and the corrosion of electrical systems, HVAC equipment and the building contents. Damages include remediation costs, diminution of property values, increased fire risk and adverse health effects to the occupants and to remediators. Generally loss costs approximate 60% of the building value. Loss exposures can be traced to “responsible parties” including developers, construction managers, general contractors, subcontractors, building products suppliers, distributors and manufacturers. Contractors remediating the drywall also have liability loss exposures and usually have significant gaps in their liability insurance coverage. Literally tens of thousands of properties and thousands of responsible parties and lenders are affected. Some trial lawyers promote Chinese drywall as the largest construction defect issue in history affecting up to 70,000 properties.

Traditional Insurance Coverage For Chinese Drywall Losses

Chinese drywall claims encompass traditional construction defect insurance coverage issues and then superimpose various “pollution” exclusion overtones. Construction defect claims introduce a series of complex insurance coverage issues in the property and liability insurance policies purchased by the stakeholders. In general, acidic gas will fall within the definition of a “pollutant” in both property and liability insurance policies because it is an “irritant” or “contaminant”. Therefore losses associated with Chinese drywall will be impacted by pollution exclusions in virtually all forms of insurance. A wide range of environmental insurance policies are available to fill coverage gaps created by pollution exclusions. For example American Safety Insurance Company has developed insurance products specifically for Chinese drywall including loss portfolio transfers for existing claims. These products and others are available through ARMR.Net.

Commercial Property and Homeowners insurance policies fundamentally insure losses from discrete fortuitous loss events that result from accidents and natural disasters. It is usually difficult to obtain coverage for a construction defect on a property insurance policy because the prerequisite “insured cause of loss” is missing to trigger coverage under the policy. Property insurance policies also have pollution exclusions. Therefore property insurance policies will usually deny a Chinese drywall loss based upon the absence of an insured peril and the effect of the pollution exclusion. As a result most property owners and their lenders will be left uninsured for the costs to remediate and restore contaminated drywall.

Commercial General Liability insurance policies have significant barriers to coverage for construction defect claims. Generally construction defect losses fail to meet the coverage trigger criteria of an accident in a CGL policy. Also exclusions for damages to “Your Work” and “Impaired Property” in a CGL policy can stand in the way of coverage for a contractor. However, if the proximate cause of the loss is materials supplied by the contractor, the effect of these “operational” exclusions becomes more clouded and the focus shifts to Property Damage and Bodily Injury losses and the various pollution exclusions that can be found in CGL insurance policies. The off-the-shelf ISO Commercial General Liability policy with the standard pollution exclusion (f.) is not supposed to apply to losses arising from products or completed operations. Virtually all losses associated with Chinese drywall with the exception of the restoration

contractors' operations should arise from products or completed operations. Therefore any of the responsible parties associated with a Chinese drywall loss that have an off-the-shelf ISO GL policy without a "Total" pollution exclusion endorsement should have liability insurance available to at least defend a claim associated with Chinese drywall. In contrast if the GL policy has a "Total" pollution exclusion endorsement, pollution losses from products and completed operations are excluded and separate environmental insurance coverage will need to be purchased to fill the resulting coverage gaps in the GL policy. Remedial contractors will need specially modified liability insurance packages to perform any work on Chinese drywall. Commercial property owners will need to amend their insurance requirements for their vendors in contracts and purchase EIL coverage accordingly. Lenders need to amend their insurance requirements of commercial borrowers for this new risk. All stakeholders need a review of their current GL and environmental coverage to evaluate potential coverage gaps. ARMR.Net provides these insurance products and consulting services to our clients.

ENVIRONMENTAL INSURANCE SOLUTIONS

Commercial environmental insurance policies are available to address a wide range of outdoor and indoor air pollutants including mold, asbestos, lead, silica and the effects of Chinese drywall.

NEEDED INSURANCE COVERAGES FOR PROSPECTIVE* OPERATIONS:

- Environmental Impairment Liability for third party damages plus first party coverage for remediation, restoration costs and loss of rents. All commercial property owners need this coverage.
- Contractors Pollution Liability, third party damages including clean up and restoration costs.
- Professional Liability for contractors and consultants
- General Liability with Completed Operations and/or Products Pollution liability
- Restoration Contractors will need specially modified liability insurance packages

TARGET MARKETS FOR INSURANCE AGENTS AND BROKERS:

- Contractors
- Commercial Property Owners
- Condominium Associations
- Developers
- Building materials manufacturers and distributors
- Financial Institutions

MINIMUM PREMIUM: \$3,600 CPL

\$9,000 EIL with coverage for mold and Chinese drywall
\$25,000 GL with products pollution

ARMR.Net offers access to a wide range of high quality environmental specialty insurance markets. Each risk will be evaluated and coverages and market(s) will be recommended based on the parameters of the risk. ARMR.Net brings to the table creative and highly skilled environmental insurance design and placement specialists ready to assist in the development of custom designed insurance products to meet our clients' risk transfer goals.

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* Environmental insurance policies will not normally cover previously uninsured prior acts or operations. However continuous renewal of environmental insurance does insure completed operations which were previously insured. EIL policies can provide full prior acts coverage on commercial properties including coverage for Chinese drywall and other indoor and outdoor pollutants.