

THE PLAGUE OF THE NEW MILLENIUM: CONSTRUCTION DEFECT CLAIMS- EXTERIOR INSULATION AND FINISH SYSTEMS (EIFS), MOLD, AND THE LIKE

By: Kurtis B. Reeg

Practicing lawyers, insurers and Corporate America likely thought they had seen it all in litigation in the 1900's. The evolution of strict liability in tort, comparative fault, the asbestos elephantine-mass, lead paint claims, nursing home litigation, bad faith litigation against the insurance industry, and the reign of class actions all had us thinking the bad could probably never get worse, and there must be an end to this insanity at some point in time. Maybe the War on Terrorism or the Battle for Iraqi Freedom, coupled with another Bush Presidency armed with a Republican-controlled legislature could finally bring an end, or at least some limits to, the runaway litigation train. Sure, the organized plaintiffs' bar continued to prove its ingenuity. Well-heeled by the wealth transfer visited upon American industry, ATLA and the like fostered their networking advantage to launch web site after web site in its reconstitution of business through judicial activism. Surely the end is in sight, right? Not so fast.

What began as a crawl in construction litigation in the 1990's has grown exponentially in the first years of this Millennium. As one can see from the popular press, trade journals and the balance of this paper, construction defect claims (CDC—thought until recently to have stood for the Center for Disease Control) persist on a protracted basis. Sure, lawyers and aggressive courts help fuel the fury. But alas, we find both nature and capitalistic ingenuity to nourish rather than deflect this litigation. In an effort to deconstruct this current litigation rage, we play the devil's advocate and take a plaintiff's typical (and typically somewhat cynical and sarcastic) view in an effort to manage not only this risk but others which continue to evolve before the defense bar and its clients. We then turn to the results of recent litigation as a basis for our discussion as to

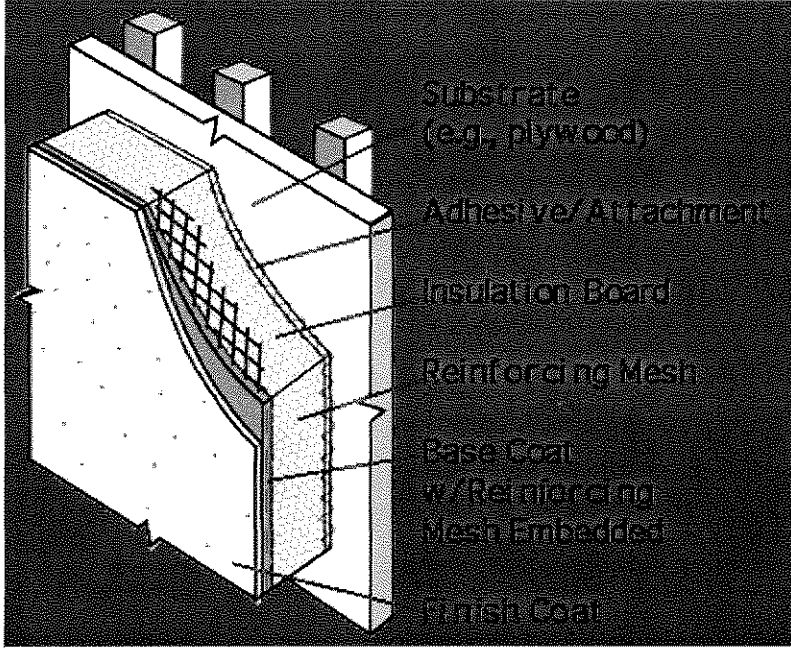
whether there is coverage for such EIFS and other CDC claims. Whether a crisis in available coverage looms will then be discussed.

And he shall look on the plaque, and behold, if the plague be in the walls of the house with hollow strakes, greenish or reddish, which in sight are lower than the well; then the priest shall go out of the house to the door of the house, and shut up the house seven days; and the priest shall come again the seventh day, and shall look: and, behold, if the plague be spread in the walls of the house; then the priest shall command that they take away the stones in which the plague is, and they take away the stones in which the plague is, and they shall cast them into an unclean place without the city.

Leviticus Chap. 14, verses 37-40

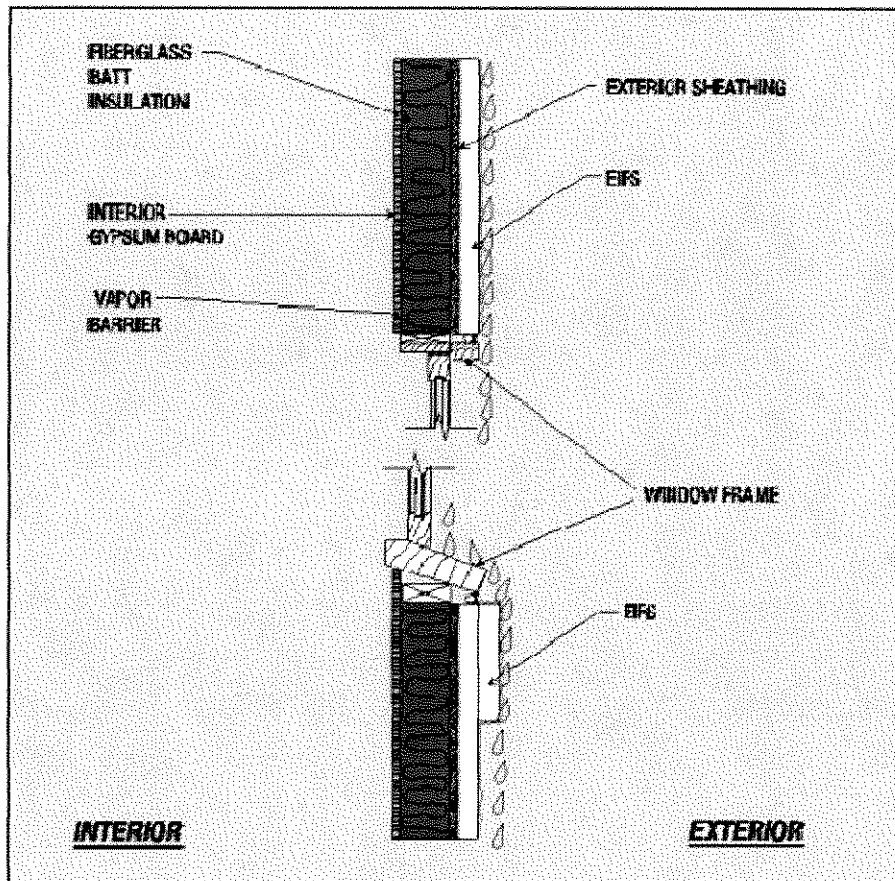
1. How This Litigation Started.

Did the educated founding fathers of modern civilization really portend this EIFS litigation? We doubt it, but their fortune-telling was prophetic. The multi-layered exterior wall systems officially known as Exterior Insulation and Finish Systems (EIFS), but commonly referred to as synthetic stucco, are composed of insulation board made of: synthetic foam; applied with an adhesive, a durable, allegedly water-resistant base coat which is reinforced with fiberglass; and an intransient finish coat which is both crack-resistant and colorfast.



<http://www.toxicmoldlegalnetwork.com/ppt/dallas/sld018.htm>

Face Seal Barrier



<http://www.toxicmoldlegalnetwork.com>

It was developed in Europe in the 1950's and introduced into the United States around the early 1970's. According to the manufacturers' trade association EIFS Industry Members Association (EIMA) (which consists of 434 members), EIFS accounts for almost "30% of the U.S. commercial exterior wall market and nearly 2% of the residential wall market."

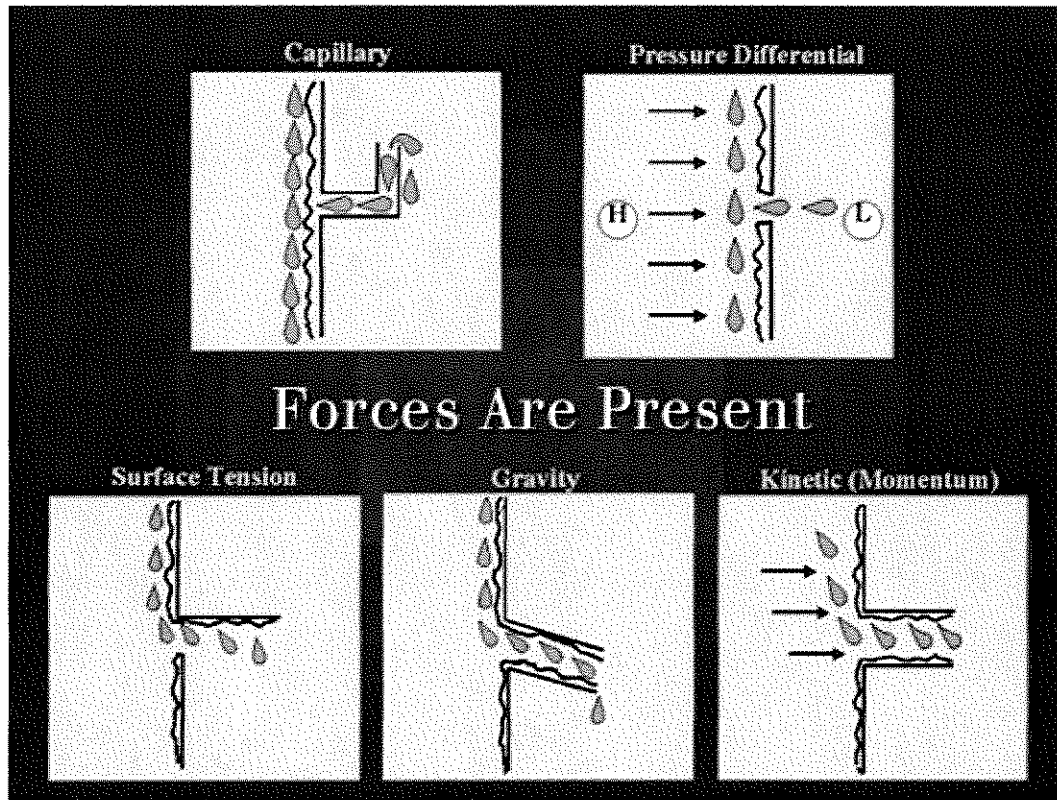
www.eima.com/eima/eifs.com. It is marketed as a beneficial and long-lasting exterior surface.

If statistics are any measure of success, then EIFS should have been an entrepreneur's dream product. A 1998 analysis by Ducker Research Company, likely conducted at the urging of the EIMA, reports that

approximately 322 million square feet of EIFS were installed in the United States in 1997, of which 216 million square feet were used on commercial projects. Today, with a 22% share of the market, EIFS are the most widely used wall cladding in commercial construction in this country. Assuming the continuation of the current favorable economic climate, the growth of EIFS is expected to remain at 8-10% annually over the next five years.

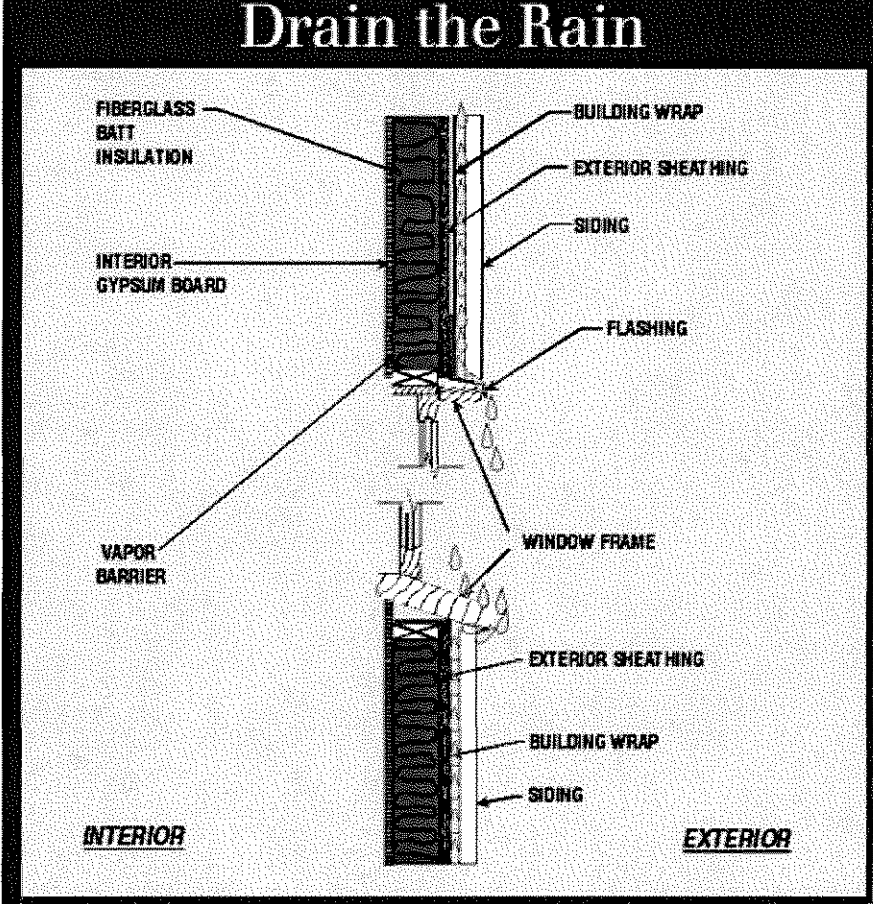
“EIFS in Commercial Construction,” A Position Paper [White Paper] prepared by the EIFS Industry Members Association, www.eima.com/insurance/whiteppr.htm.

The problem is, water can seep into an improperly installed system. Various physical forces affect the retention of water and moisture.



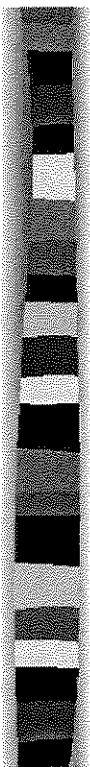
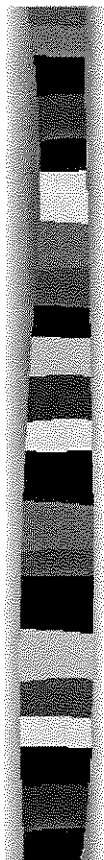
<http://www.toxicmoldlegalnetwork.com>

Thus, the EIFS construction should both seal out water, and drain away any rain, water or moisture from which enters or presents itself within the interior of the wall system.



Id.

Otherwise, the effects can be dramatic and horrid.









<http://www.stuccolaw.com>

One need not ponder long the use of an industry “White Paper” as Plaintiffs’ Exhibit 1 in some of the cases to be discussed below, to imagine how some of the reported verdicts have resulted. Picture if you will the dripping sarcasm of plaintiffs’ counsel in her closing argument regarding a soggy brown-gray mold infested, water-stained and crumbling office building wall system when she quotes the White Paper as saying:

EIFS have been the subject of some negative publicity involving moisture intrusion in residential construction....In the commercial sector, EIFS have enjoyed remarkable success since the introduction of the system to this county 30 years ago. **Billions of square feet** have been installed and are in sue today. Architects continue to specify EIFS more than any other type of exterior cladding for commercial use because of the design versatility, energy efficiency, and cost effectiveness of the system. **Billions of square feet** have been installed and continue to perform successfully. (Emphasis added.) *Id.*

“Except for the thousands of square feet of my client’s building,” she retorts!

If EIFS is so great, what happened? As it turns out, the advertised benefit of this product is, in part, its own undoing. It is advertised for its **energy efficiency**.

If you've ever felt the comfort of being wrapped in a warm blanket on a cold winter night, you have some idea of what EIFS can do for a home or building. EIFS literally wrap the exterior in an energy-efficient thermal blanket. By insulating outside the structure, EIFS reduce air infiltration, stabilize the interior environment and reduce energy consumption....In fact, EIFS can reduce air infiltration by as much as 55% compared to standard brick or wood construction. www.eima.com/eima/eifs.htm.

Snorts plaintiffs' counsel, "when a reasonable person rolls himself up in a sleeping bag on a sultry day, he sweats, right? So, those **billions of square feet** sold by defendant don't usually sweat; they just did in my client's property, huh?" The discomfort at the defense counsel table is becoming palpable.

As the EIFS manufacturers extole, EIFS permits of **flexible design**.

The rich appearance of EIFS bears a resemblance to stucco or stone, but the systems are far more versatile than these and other materials. Not only do EIFS come in virtually limitless colors and a wide variety of textures, but they also can be fashioned into virtually any shape or design.

With EIFS, skilled applicators can create all sorts of exterior architectural detailing that would be cost-prohibitive using conventional construction—cornices, arches, columns, keystones, cornerstones, special moldings and decorative accents are but a few examples....

Using this ingenious process, EIFS applicators can give a striking, distinctive appearance to any building or residence. www.eima.com/eima/eifs.htm.

"OK, let's see," muses our plaintiffs' lawyer. "Limitless colors—like vomit green, dirt brown! Decorative accents—like an earthworm crawling out of the spongy morass that used to be my client's wall!" "Yes, indeed," she rejoins, "my client's building certainly does have a striking, distinctive appearance!" We're wincing now at the counsel table.

As for **installation**, "EIFS are definitely **not** do-it-yourself wall claddings." *Id.* The EIMA recommends that on all EIFS jobs, the customer: select an EIMA manufacturer; select a knowledgeable applicator who has the approval of the manufacturer; verify with the manufacturer that the plans provide for that "weather-type building envelope;" verify that all

components are approved by one manufacturer; verify that the proper materials were shipped and stored in accordance with manufacturer instructions; review at the start all aspects of the job with the applicator and the manufacturer; examine the substrate for cleanliness, proper tolerances, etc.; and periodically inspect the EIFS components. *Id.* “Well,” waxes the plaintiff’s mouthpiece, “my client’s architect and builder [the co-defendants over there], did all of that.”

What about **maintenance and repair** on this building? The industry says there’s nothing to it. It is simple and straight forward:

EIFS also have excellent resistance to dirt, mildew and **mold**, which helps keep the building **exterior** looking clean and freshly painted. Should the surface ever become soiled, it can usually be cleaned by **hosing it down**.

The systems are designed to be very flexible, which makes them highly crack resistant....

EIFS are among the most **water resistant exterior surfaces**, you can put on a house. But as with all claddings, EIFS must be correctly installed and properly detailed if they are to perform properly. Otherwise, moisture can get behind the systems and cause damage, just as it can with wood siding, brick or any other exterior.

Water intrusion is seldom a problem on commercial structures with EIFS. Water damage to homes is uncommon, but **when it does occur, the moisture typically affects only small areas which can be easily and inexpensively repaired.** (Emphasis added.)

www.eima.com/eima/eifs.htm. At this point, you can chirp counsel’s lines before they pass her lips. “Resistant to mold, huh? Oh yes, only on the outside!” she wails. “So it is resistant to rain and washing on the exterior surface, yes?” Here comes the funny (remember cynical and sarcastic) part: “When water damage does occur, it can be fixed easily and inexpensively. OK, so fix it!” “Since these Defendants think it is so inexpensive, I guess they can afford it, ladies and gentlemen. So they should not have any problem paying the \$____ gazillion dollars to which we are so rightfully entitled.” The defense doesn’t just rest here; they’re prostrate on the floor!

This type of scene plays itself out in courtroom after courtroom in America. Forget that this evidence of a trade association should have been barred via a motion in limine. Perish the thought that a state court judge in Anywhere, USA, would permit such bootstrapping and prejudicial argument (we never hear it in asbestos or lead litigation, right?). The architects, manufacturers, builders, contractors, suppliers and neighborhood and condominium groups, and insurers, all joined as defendants or otherwise exposed in these cases, seek to stake out their own turf, assert their differences and resurrect their defenses.

2. Risk Management or Reactionism.

In the case of EIFS, it can be argued that both have occurred. In 2001, the National Association of Home Builders' (NAHB), through its Research Center and Building Products Issue Committee, issued a pamphlet entitled: "Moisture Protection of Wood Sheathing: An Installer's Guide." (This brochure can be viewed at the NAHB website at www.nahbrc.org, or by calling the NAHB at 800.368.5242, ext. 359 or the NAHB Research Center at 800.638.8556.) While ostensibly discussing a particular kind of wood exterior wall sheathing in the form of plywood or Oriented Strand Board (OSB), this pamphlet (which in reality provides little in the way of detail) essentially implies that virtually all external wall envelopes (whether brick, veneer, stucco, synthetic stucco, etc.) must address the same concerns: moisture penetrating the external envelope and removal of whatever moisture enters or develops the inner spaces of the wall system. This effectively permits the overlay of EIFS-specific issues onto other industries which, up to this time, had been relatively immune from CDC litigation.

In fact, because the EIFS industry was being inundated with litigation, its Executive Director penned a missive geared toward Insurance Executives on the EIMA web site which raised the disquieting hypothetical: "[C]an any wall cladding be expected to perform to the

manufacturer's specification, if there are deficiencies, or omissions in the exterior wall envelope, which includes the windows, roof, downspouts, diverters and gutters? Compelling evidence is now surfacing that moisture intrusion, especially in the wall cavity, is a problem that reflects shoddy construction practices and inadequate flashing, rather than the merits of any particular wall cladding." Indeed, to lend an air of authority to the point, a North Carolina County Chief Building Inspector was referenced (but not quoted) to the effect that wood rot results from moisture intrusion **in all types of residential construction** in the Wilmington, North Carolina area. Moreover, this issue was allegedly significant enough to raise the eyebrows of Uncle Sam, as "the Federal government has launched studies to explore water problems in new homes, according to a recent article in the Minneapolis Star Tribune." No specific citation to the article or the government study were given. www.eima.com/insurance/media/2000/bylined_01.htm. One wonders how loud the thud at the home remodeling, gutter contractor and masonry institutes across the land when this position crossed their eyes. If Corporate America has learned anything from our litigious society, it should be that sniping at one's corporate colleagues often portends disaster across the board. In any given lawsuit, it surely drives up the damages award. Moreover, it simply is not good business.

The insurance industry also started to act and react. An insurance broker penned an article in one of the major building trade publications regarding the ripple effect of EIFS litigation on insurers. Stickland, Scott, "CDC's: The Contractor's Virus," *Building Design & Construction* (2001). This article accurately noted the avalanche of CDC litigation in the West (especially California and Nevada) and the Pacific Northwest, including Washington from whence that author hailed. It noted that at some point in time, owners of property should rightfully assume maintenance responsibility for property maintenance, rather than forever look

to the builder and general contractors to maintain their work. But then it directed these entities to bring their insurers to the party:

If sued, the A/E/C firm should obviously report a CDC to its insurer. The Company also must fulfill the loss-reporting conditions of your insurance policy (property, builder's risk, general, professional or excess liability) when you are aware of an incident that may result in a claim long before a suit is filed.

Timely reporting is critical so that the company can avoid a reservation-of-rights action by its insurer. The company may impair its insurer's ability to defend it (and them) by late reporting. *Id.*

The article also went on to report the reaction of the insurance industry to the proliferation of such claims.

Non admitted insurers have issued new general liability policy forms and added endorsements to prevent the CDC infection from spreading among multiple policy periods. They are also placing defense costs within the indemnity limits, so attorney's fees will displace the amounts available for a settlement. In addition, known losses are now being excluded prospectively from the renewal policies.

CDCs are driving standard insurers from the construction insurance market. For residential and commercial builders, cancellations and non-renewals are being imposed. Those companies that have not yet gone through the renewal process are in for a rude awakening. As premiums expire, new deductibles, called self-insured retentions, or SIRs, are skyrocketing from \$5,000 to as much as \$100,000 per occurrence.

This rise in insurance costs will have long-term effects on the general construction and real estate markets, causing construction costs to rise significantly and forcing marginal contractors out of business. CDCs should be one of the catalysts for the next downward cycle of building construction.

A more streamlined and less costly method of adjudicating these claims is needed. In many ways, the present situation is similar to the growth of pollution liability issues of 30 years ago, when problems were generally known but decades passed with little or no cleanup. It took considerable legal effort to move the wheels of justice and initiate significant environmental cleanup work. *Id.*

The EIMA reprinted a portion of this article on its website.

www.eima.com/insurance/media/2001/media_01.htm. While the article can be viewed as merely recommending good risk management and loss control practices, the commentary regarding insurers' reactions arguably speaks otherwise.

3. The EIFS and Mold Litigation Wars.

There can be no dispute that EIFS, mold and related claims are proliferating. In only the last few years, large awards and verdicts are reported everywhere. We present only a smattering of those cases, in an effort to demonstrate the nature and scope of this litigation, and to give a back drop to the insurance- and remediation-related issues discussed herein.

A. The Louisiana-Pacific (LP) Corp. Inner-Sealing Siding Litigation.

The Inner-Seal national siding class action litigation reached a supplemental settlement which involves products installed prior to January 1, 1996. Prior resolutions included the Second Settlement Fund administered in 1998 and the Alternative Payment Program introduced in 2002. Announced in April, 2003, the Claimant Offer Program is being instituted under the direction of Retired Oregon Supreme Court Justice Richard Unis, a Special Master appointed by the United States District Court for the District of Oregon, who is overseeing the administration of this opt-out settlement. The Program allows homeowners to make offers to LP in exchange for a release of their claim. The Program guarantees approval of offers up to 35.87 percent of a homeowner's approved claim, and allows for review but no guaranteed acceptance of offers in excess of 35.87 percent. Offers were to be postmarked by April 30, 2003, with responses, including payment if allowed, no later than June 30, 2003. More information regarding this matter can be obtained from LP's website at www.lpcorp.com or the claims site at www.lpsidingclaims.com.

B. *In the Matter of the Arbitration between Molley Peters and Jeffrey Jay and Arthur F. McMurdie and Nelson Construction Services and Eric Nelson*, AAA No. 16 110 00363 01 (February 7, 2003).

While no details are publicly available on this case, homeowners were awarded damages for allegedly defective EIFS in the following amounts:

\$146,665 for EIFS removal, replacement and related repairs;
\$ 1,480 for reimbursement of the cost of the expert Exponent's report;
\$ 25,555 in interest; and
\$ 43,425 in attorneys' fees
\$217,125 Total (plus various costs)

C. *Dryvit EIFS Stucco Class Action Settlement, Posey v. Dryvit Systems, Inc.*, #17,715-IV (Cir. Ct. Jefferson Cty., TN 2003).

On January 14, 2003, the Court granted final approval to this class action which involves all persons who, as of June 5, 2002, owned a one- or two-story family residence or townhouse in any State other than North Carolina clad, in any part, with an EIFS manufactured by Dryvit Systems, Inc., and installed after January 1, 1989. The opt-out deadline for the class was September 3, 2002, and the deadline to file a claim form is June 5, 2004. The benefits of the settlement include a free property inspection, a Settlement Program Three-Year Limited Warranty (the "Moisture-Free Warranty), cash contributions toward certain repair costs, and the payment of fees and expenses of the attorneys and claims administrators. The Warranty provides full term coverage limits of \$30,000, and annual limits of \$10,000 to pay for repairs necessary to prevent the intrusion of excessive moisture (an interesting concept under the circumstances) behind the cladding system. Depending on the estimated costs of repair, the settlement is \$6-\$7 per square foot of EIFS.

As certain plaintiffs' counsel have described it, "even at \$7.00 per square foot, the settlement is a rip off. For example, it's not uncommon for total repair costs on a 3000 square foot house to be approximately \$75,000. Under the settlement agreement, Dryvit would pay

roughly \$15,000-\$20,000, well short of what is needed, and very short if there is mold contamination.” Bryson, Dan, www.stuccolaw.com/news/hot_current.html (Feb. 2003). This same lawyer notes that Dryvit obtained a defense verdict in *Columbine Place v. 605 Standiford Place (Modesto, CA)*. Given the number of challenges to class action settlements, and awards of attorneys’ fees, launched by various plaintiffs’ firms against their sister and brother plaintiffs’ counsel, Corporate America and their counsel obtain some solace that the shoe is sometimes on the other foot, when plaintiffs’ counsel snipe amongst themselves. However, any momentary glee can evaporate with a successful challenge which can abort a class settlement, causing the corporate defendant additional angst and expense.

D. *Board of Directors of the Bay Point Condominium Association, Inc. v. RML Corp.*, No. CL99-475 (Norfolk, Vir. Cir. Ct. Jan. 28, 2002).

In another Dryvit-based EIFS case, a consent judgment was entered on a settlement in the amount of \$4,000,000, which the Court found reasonable. Zurich, the insurer of RML, the general contractor, had paid \$1,400,000. RML had third-partied both Dryvit and Bishop, the Dryvit EIFS distributor, Kemp, the subcontractor who installed the EIFS, and several other contractors and materialmen. While Dryvit obtained summary judgment in the direct action by Plaintiffs against it, RML entered into a settlement in which it assigned to Plaintiffs any and all rights against Dryvit and Bishop. After a trial where Plaintiff’s former counsel represented RML, the settlement and consent judgment are reached.

E. Santa Clara County Courthouse EIFS/Mold Case Settled for \$12 Million.

The County claimed that the EIFS envelope to its new 33,000 square foot justice center had defects which permitted no internal drainage, such that leakage damaged the wood framing, exterior sheathing and interior drywall. Destructive testing showed extensive mold growth in the exterior wall cavities. All of the court functions were transferred to other quarters. At least 12

employees filed bodily injury claims against various contractors, architects and suppliers. With the announcement of the settlement, the County declared that it would convert the courthouse into “a generic county office building.” (Presumably, non-judicial Santa Clara employees are less susceptible to mold and other contaminants?) In place of the old courthouse, the County is building a \$22 million, 60,000 square foot justice center, utilizing \$7 million in newly found redevelopment funds.

F. *Stafford v. County Developers and Parex, Inc.*, No. 181-455 (Fairfax Cty. Cir. Ct. 2001).

Brian L. Stafford, the head of the U.S. Secret Service, and his wife won \$1,280,000 when their EIFS system failed and allowed water to seep into and damage the home. When sections of the stucco were cut away, they found “rotted wood that crumbled like mulch.” “When we pulled one piece of the stucco off, an earthworm crawled out of the wood. It was devastating to see that.” *National Law Journal*, “‘Explosion’ of Cases Involving Synthetic Stucco Being Filed” (Aug. 3, 2001). According to the Washington Post, about 200 such cases were pending in the Washington, D.C. area in 2001, and a Vienna, VA, couple obtained \$1,400,000 in another EIFS case in September, 2000. *Washington Post*, “\$1 Million Awarded for Faux Stucco On Va. Home” (July 24, 2001).

4. Where Do We Go From Here?

The trail of CDC class actions and sizeable verdicts continues regarding EIFS and mold. Hundreds of pages have been written in both the popular press and legal and trade/industry journals regarding this litigation morass. The insurance industry is then confronted with the coverage issues under the various types of policies. The seminal construction defect case of *Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979), is considered the first definitive

analysis of the dichotomy between liability based, on the one hand, on contract and warranty law for defective products and workmanship (which are not covered by CGL policies) and, on the other hand, tort liability for bodily injury and property damage for which there is coverage. We now turn to that analysis.