

# Has Chinese Drywall Affected the Economic Loss Rule?

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Starting in 2009, Virginia courts have seen a wave of construction cases related to the installation of drywall manufactured in China (Chinese drywall) in homes. Similar to the exterior insulation and finishing system (EIFS) cases that preceded Chinese drywall, decisions in recent Chinese drywall cases continue to shape Virginia's application of the economic loss rule to construction disputes.

## Brief History of Chinese Drywall

In December 2008, the U.S. Consumer Product Safety Commission (CPSC) started receiving complaints from homeowners about Chinese drywall.<sup>1</sup> Since that time, the CPSC has received thousands of complaints. While most of the complaints have been filed by Florida and Louisiana residents, complaints by Virginia residents ranked fifth on the CPSC's list of states with complaints.<sup>2</sup>

With such complaints also comes litigation, and Virginia state and federal courts have seen a flood of Chinese drywall filings since 2009. Homeowners are filing many of these lawsuits while others are filed by insurance coverage. Some of the Virginia federal cases have been transferred to the U.S. Judicial Panel of Multidistrict Litigation in Louisiana for coordinated pretrial proceedings<sup>3</sup>, with insurance coverage disputes and state court actions remaining in Virginia courts. (Cases before the panel are referred to as Chinese Drywall MDL.)

Some similarity exists in the complaints made by homeowners with Chinese drywall.<sup>4</sup> They have complained of a "rotten egg" or sulfur smell in their homes, and they have reported that metal components of their homes have blackened and corroded. Homeowners have complained that they frequently have had to replace components of their air conditioning units. Homeowners also have complained about problems with electronics and appliances and damage to other personal property. Some homeowners also have alleged that

they have experienced health issues while living in homes with Chinese drywall.

There also is some similarity in the types of claims filed by homeowners with Chinese drywall and the types of defendants named. Homeowners are filing lawsuits that include claims for breach of contract, breach of express and implied warranties, negligence, and violation of the Virginia Consumer Protection Act. Homeowners are naming builders, suppliers, and manufacturers as defendants.

## History of Economic Loss Rule

When addressing whether the economic loss rule applies to a particular case, many courts cite a unanimous 1986 decision by the U.S. Supreme Court in *East River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858 (1986). In *East River*, the Court answered in the negative the question of whether a cause of action in tort is stated when a defective product malfunctions and injures only the product itself and causes purely economic loss.<sup>5</sup> The Court indicated that products liability came from a concept that people need more protection from dangerous products than that provided by warranty law, but the Court cautioned that if this development "were allowed to progress too far, contract law would drown in a sea of tort."<sup>6</sup>

In *East River*, the Supreme Court concluded that when a product injures only itself, the reasons to impose a tort duty are weak, and reasons for leaving the party to its contractual remedies are strong.<sup>7</sup> The manufacturer owes no duty under a products liability theory based on negligence to avoid causing purely economic damage.<sup>8</sup>

The Supreme Court of Virginia relied on *East River* in its 1988 decision in *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*<sup>9</sup> In *Sensenbrenner*, plaintiffs claimed that a negligent design by the architect and negligent construction by the contractor caused a swimming pool to settle and water pipes to break. Water from the broken water pipes eroded the soil under the pool and part of the foundation of the home.<sup>10</sup> Citing *East River* regarding when a product injures only itself



because one of its components is defective, the Supreme Court of Virginia ruled that no tort claim will lie for a purely economic loss sustained by the owner of the product.<sup>11</sup> Because the damages were economic losses, not injuries to property, the home purchasers could not recover against the architect or pool contractor for damages to the swimming pool and the foundation of the house caused by the leaking pool, where the architect and pool contractor were not in privity of contract with the home purchasers.<sup>12</sup>

The Court concluded that the effect of the substandard parts was a diminution in value, measured by the cost of repair. Thus, the effect is a purely economic loss for which the law of contracts provides the sole remedy.<sup>13</sup> Recovery in tort is available only when there is a breach of duty to take care of the safety of the person or property of another. The Court concluded that the architect and pool contractor assumed no duty to the home purchasers by contract, and no breach of a duty imposed by law had been alleged.<sup>14</sup>

Applying the economic loss rule in construction cases since *Sensenbrenner*, Virginia courts have dismissed negligence claims in which plaintiffs have sought to recover for only economic loss from parties with which plaintiffs were not in privity of contract.<sup>15</sup> Only when plaintiffs have sought to recover for bodily harm or damaged property has a tort claim been permitted to lie absent a contract.<sup>16</sup>

Similar results have been seen in EIFS cases in which homeowners or homeowner associations pled negligence claims against EIFS suppliers and manufacturers. Circuit courts applied the economic loss rule to EIFS claims, dismissing negligence claims in which plaintiffs were not in privity of contract with defendants and failed to allege an injury to person or property.<sup>17</sup> In the EIFS cases, plaintiffs argued that the EIFS allowed water infiltration into the structure and the water damaged "other property" such as doors, so the economic loss rule did not apply. Such arguments were rejected by most courts. The Virginia Beach Circuit Court, for example held that a negligence claim against the EIFS manufacturer was barred:

Lesner Pointe contracted with the builders for the construction of condominiums that included the installation of EIFS. Water intrusion damaged the EIFS and caused wood rot and other structural damages. Although the plaintiff claims that the recovery is sought for damages to the component parts, the plaintiff's negligence action

attempts to recover in tort for damage to the condominiums, the subject of the contract. Although plaintiff attempts to save this cause of action by alleging the jeopardized health of the individual condominium owners due to the accumulation of mold, the plaintiff has not provided this Court with any specific allegations of actual injury to persons to support a negligence action.<sup>18</sup>

### Applying the Economic Loss Rule to Chinese Drywall Cases

Similar to the EIFS cases, defendant suppliers and manufacturers are raising the economic loss rule as a defense to negligence claims filed by Chinese drywall homeowners. But unlike the EIFS cases, courts are denying such motions and permitting homeowners to pursue negligence claims against suppliers and manufacturers.

In the Chinese Drywall MDL, U.S. District Court Judge Eldon E. Fallon ruled that plaintiffs' negligence claims against the suppliers and manufacturers were not barred by the economic loss rule because the economic loss rule has no relevance to products that pose "an unreasonable risk of harm to plaintiff's property and health, but do not fail to meet their intended purpose.... Moreover, the [economic loss rule] is not applicable where there are claims that the defective product caused personal injury."<sup>19</sup>

At least two similar results have been seen in Virginia circuit courts in Chinese drywall cases, with the courts denying demurrers to negligence claims. In a case brought by Chinese drywall homeowners in Virginia Beach, Virginia Beach Circuit Judge Patricia L. West denied defendants' demurrer to the negligence count, stating at the hearing that the Chinese drywall situation is "clearly different" from the EIFS situation.<sup>20</sup> In a decision issued in Norfolk in consolidated

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Chinese drywall cases, the Norfolk Circuit Court Judge Mary Jane Hall overruled demurrers filed by defendants to a negligence claim for reasons similar to those outlined by Judge Fallon in the Chinese Drywall MDL.<sup>21</sup>



In the Norfolk cases consolidated before Hall, the defendants cited *Sensenbrenner* and argued that the economic loss rule bars plaintiffs from recovering economic damages such as costs to repair the drywall and repair damage to their homes. At oral argument, some of the defendants conceded that the plaintiffs may sue in negligence for personal injury and for damage to property that was not part of the home itself, but the defendants argued the remaining damages are barred by the economic loss rule. Judge Hall disagreed with the defendants and declined to find that the negligence claim was barred by the economic loss rule. She relied on an asbestos fireproofing case issued by the Fourth U.S. Circuit Court of Appeals,<sup>22</sup> which applied South Carolina law in indicating that Chinese drywall is similar to asbestos fireproofing, as both products served their intended purpose but presented a potential to cause damages and personal injury.<sup>23</sup>

Courts are walking a fine line in Chinese drywall cases as they attempt to distinguish Chinese drywall from EIFS. The case law in *East River* and *Sensenbrenner* provides grounds for maintaining the portion of negligence claims based on alleged personal injury and damage to property that is not a part of the home. Whereas *Sensenbrenner* and earlier EIFS cases struck negligence claims seeking to recover damage to the product, the courts in Chinese drywall cases are permitting such claims to proceed against suppliers and manufacturers based on the alleged "unreasonable risk of harm to plaintiff's property" and an alleged duty owed by suppliers and manufacturers. Only time will tell the long-term effects of this wave of Chinese drywall cases on the economic loss rule. ☞

## Endnotes:

- 1 <http://www.cpsc.gov/info/drywall/where.html>
- 2 *Id.*
- 3 <http://www.laed.uscourts.gov/drywall/drywall.htm>
- 4 <http://www.cpsc.gov/info/drywall/where.html>
- 5 476 U.S. at 859.
- 6 *Id.* at 866.
- 7 *Id.* at 871.
- 8 *Id.* at 876.
- 9 236 Va. 419, 374 S.E.2d 55 (1988).
- 10 *Id.* at 422, 374 S.E.2d at 56.
- 11 *Id.* at 424, 374 S.E.2d at 57.
- 12 *Id.* at 424, 374 S.E.2d at 58.
- 13 *Id.*
- 14 *Id.* See also *Kamlar Corp. v. Haley*, 224 Va. 699, 706, 299 S.E.2d 514, 517 (1983) ("Damages are awarded in tort actions to compensate the plaintiff for all losses suffered by reason of the defendant's breach of some duty imposed by law to protect the broad interests of social policy....Damages for breach of contract, on the other hand, are subject to the overriding principle of compensation....They are limited to those losses which are reasonably foreseeable when the contract is made. These limitations have led to the 'more or less inevitable efforts of lawyers to turn every breach of contract into a tort.'") (citation omitted); *Filak v. George*, 267 Va. 612, 618, 594 S.E.2d 610, 613 (2004) ("The law of torts provides redress only for the violation of certain common law and statutory duties involving the safety of persons and property, which are imposed to protect the broad interests of society.").
- 15 *Genito Glenn L.P. v. Nat'l Hous. Bldg. Corp.*, 50 Va. Cir. 71 (Va. Beach 1999) (sustaining demurrers to negligence claims because damages sought by the plaintiffs were purely economic losses); see also *Metro Panel Sys. Inc. v. Sordoni Skanska Constr. Co.*, 56 Va. Cir. 399 (Va. Beach 2001) (awarding summary judgment to defendants not in privity with the plaintiff when the plaintiff only was seeking to recover economic losses); *City of Portsmouth v. Cederquist Rodriuez Ripley PC*, 72 Va. Cir. 405 (Portsmouth 2007) (holding that allegations contained in complaint were firmly grounded in contract, not tort, when the relationship between parties are all based upon written contracts).
- 16 *Travelers Prop. Cas. Co. of Am. a/s/o Covenant Woods v. Premier Project Mgmt. Grp. LLC*, 78 Va. Cir. 315, 318 (Hanover County 2009) ("If PPMG claimed that the defendants caused bodily harm, or damaged PPMG property, a cause of action in tort could lie. In a claim for purely economic damages, however, no duty of care or skill may be imposed absent a contract, and so there is no tort cause of action.") (citations omitted); *Commonwealth Park Suites Hotel v. Armada/Hoffler Constr. Co.*, 34 Va. Cir. 393, 396 (Richmond 1994) ("my ruling is based on my belief that *Sensenbrenner* and the other *Sensenbrenner*-type cases, while appropriately fashioning a rule to address the normal dichotomy between cases involving injury to persons or property on the one hand, and those which do not involve such injury on the other, simply do not apply to cases such as this one where toxic contamination of a landowner's air is alleged.").
- 17 *Lesner Pointe Condo. Ass'n Inc. v. Harbour Point Bldg. Corp.*, 61 Va. Cir. 609 (Va. Beach 2002) (dismissing the negligence claim against Dryvit based on economic loss rule); *Stoney v. Franklin*, 54 Va. Cir. 591 (Suffolk 2001) (dismissing the negligence claim against manufacturers and supplier based on economic loss rule); *MacConkey v. F.J. Matter Design Inc.*, 54 Va. Cir. 1, 6-7 (Va. Beach 2000) ("[General contractor] FJ Matter fails to distinguish the injury allegedly caused by EIFS in this case from the damage that resulted in the *Sensenbrenner* or *Cincinnati Ins. Co.* cases. Plaintiffs in those cases sought damages not only for injury to the product itself but for damages to the foundation of their nearby home and actual damage to the collapsed building, respectively. FJ Matter has suffered no loss itself. Its losses are those of the MacConkeys, who, like the plaintiffs in *Sensenbrenner* purchased a package deal for a new home. The failure of one of the component parts in that package caused a diminution in the value of the home and necessitated repair work. The loss is disappointed economic expectations."); *Bay Point Condo. Ass'n Inc. v. RML Corp.*, 52 Va. Cir. 432 (Norfolk 2000) (dismissing negligence claim against EIFS manufacturer).
- 18 *Lesner Pointe*, 61 Va. Cir. at 613.
- 19 *In re: Chinese Manufactured Drywall Prods. Liab. Litig.*, MDL No. 2047.
- 20 *Proto v. The Futura Group LLC*, Case No. CL09-2455 (Va. Beach). The order was entered by Judge West on February 5, 2010.
- 21 *In re: All Pending Chinese Drywall Cases*, Civil Action Nos. CL09-3105; CL09-5127 (Norfolk March 29, 2010) (other civil action numbers excluded from footnote).
- 22 *City of Greenville v. W.R. Grace & Co.*, 827 F.2d 975, 977-78 (4th Cir. 1987) ("By contrast, the injury that resulted from the installation of Monokote in this case is the contamination of the Greenville City Hall with asbestos fibers, which endanger the lives and health of the building's occupants. In our opinion, this is not the type of risk that is normally allocated between the parties to a contract by agreement, unlike the risk of malfunctioning turbines at issue in *East River* or the risk of faulty roofing shingles involved in *Watermark*.").
- 23 *In re: All Pending Chinese Drywall Cases*.