

# Chinese Drywall Remediation: What Needs to be Imported into your Construction Contract?

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If you haven't heard of "Chinese Drywall" yet, you soon will. In simple terms, Chinese Drywall is the common name used to refer to tainted or defective drywall imported to the United States from China, possibly as early as 2001, but primarily during the real estate and construction boom between 2002 and 2007, which caused a shortage of U.S. manufactured drywall resulting in the use of imported materials. The drywall is said to give off a sulfurous "rotten egg" or "burnt match" odor, to tarnish metals, and to ruin appliances and electronics by corroding pipes and wires (most damage first being detected in air conditioning units). Some owners also claim the defective drywall causes health problems, including nosebleeds, headaches and sore throats. News reports indicate that as many as 100,000 homes nationwide may be affected.

With the full impact of this defective wallboard not yet currently known, Chinese Drywall could be the "asbestos" of this era. While most in the construction industry and government are currently focused on identifying which structures contain Chinese Drywall and the related health effects of exposure, the focus will soon turn to what exactly needs to be done to get rid of the problem. It appears the only way to completely remediate the problem is to remove and replace every board in the property. This will likely include removing and replacing all finishes, such as flooring, baseboards, kitchen cabinets and appliances, backsplashes, light fixtures, door frames, etc. It has not yet been determined whether air conditioning ducts, electrical wires, nails, screws and framing will also need to be removed and replaced. In many instances however, appliances and equipment will need to be replaced, such as air conditioning and water heater units, built-in microwaves and intercom systems. This is where a properly drafted construction contract is going to be crucial.

While most industry form contracts cover the fundamental issues, many of the most essential terms involved in this kind of remediation project are simply not addressed. The following are some examples of the types of provisions that must be imported into any Chinese Drywall remediation contract:

**Occupational Safety Health Act ("OSHA").** Although most construction contracts contain general language stating that the parties agree to "comply with all laws," owners entering into Chinese Drywall remediation contracts should specifically require their contractors (and subcontractors) to

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comply with all applicable OSHA regulations and to retain liability for any failure to do so. Employers (i.e., contractors, subcontractors, etc.) will need to consult with attorneys who specialize in OSHA compliance to determine whether (and what) steps need to be taken to protect their workers during remediation and whether personal protective equipment ("PPE") will be required by OSHA. If PPE is required, a program must be implemented which addresses the hazards present at the site; selection, maintenance and use of PPE; training of employees; and monitoring to ensure the program's ongoing effectiveness.

**Compliance with Environmental Laws.** While most construction contracts contain a general section on hazardous materials and compliance with applicable environmental laws, in projects dealing with the removal and disposal of potentially toxic substances, it is crucial that proper language and allocations of risk be addressed by an attorney with experience in this area. The parties will need to determine the protocol for removing the materials and which party will be responsible for its proper disposal. Liability for such removal and disposal following the contract term should be specifically addressed.

**Adequate Insurance Coverage & Deductibles.** While most construction contracts have template language regarding the types of coverage that should be maintained, it is imperative that parties to a Chinese Drywall remediation contract specifically consult with their respective insurance advisors and attorneys to determine the type and amount of insurance coverage necessary to cover the unique risks involved. For example, not all general liability policies are the same and many contain broad exclusions which ultimately render the policy useless. In the case of defective drywall which is off-gassing volatile organic compounds, many insurers may argue that the pollution exclusion avoids coverage. Additionally, the amount of liability coverage carried by a contractor is going to be essential to the owner; thus, project specific insurance provisions should be addressed, evidence of procurement of insurance, obligations of subcontractors, and coverage exclusions in subcontractor policies. It is important that each party understands what type of coverage they do and do not have.

**Adequate Indemnification Provisions.** Standard form contracts generally do not allow parties to properly shift the risks of a project in accordance with their needs. A commercial or residential owner may require indemnification language which obligates the contractor to indemnify the owner from claims or losses resulting from defective performance of the contractor's work (such as improper disposal of toxic substances or contamination of adjoining property). Contractors, however, may be wary of agreeing to a broadly phrased indemnification provision, particularly one which requires indemnification for acts that are not their own (such as when the owner hires one contractor to remove tainted drywall, and another to install electrical wiring or air conditioning ducts). In some cases, the contractor may want to seek indemnification from the owner when the owner selects its own subcontractor to be used at the project to reduce costs. Owners and contractors can protect their interests and properly shift the risks on a project by carefully drafting specific indemnification provisions which comply with Florida law (i.e., Section 725.06 of the Florida Statutes relating to construction contracts and limitations on indemnification).

**Applicable Standard of Care.** Generally, standard form contracts do not specifically and sufficiently state the standard of care to be applied to contractors. Without an express standard of care provided in the construction contract (especially a standard of care to be used in dealing with the remediation of the tainted drywall and removing and replacing high-end finishes), the law will imply one which may not be what was intended by the parties.

**Warranty.** The warranty section of the Chinese Drywall remediation contract will likely be a hotly negotiated item. In order to avoid going through the same process twice, the owner will want the

broadest warranty possible from not only the contractor, but from its subcontractors and suppliers. The contractor, on the other hand, will need to determine whether it is willing to give a warranty and, if so, the limits to be placed on same. The contractor will want to ensure that its warranty is limited to just its work and not the pre-existing structure.

**Unforeseen Site Conditions & Change Orders.** Although a structure may be found to contain Chinese Drywall, for the most part, the full extent of the damage to pipes, ducts and electrical work will not be revealed until the contractor starts work on the project. Most standard construction contracts fail to address appropriate change order procedures to make certain that the owner receives the work it requires, and the contractor is paid for providing additional work requested or later discovered to be required. An appropriate change order provision is essential as courts do not uniformly interpret change order clauses and the course of dealings between the parties. In that regard, a well-written contract should include, among other things, provisions making clear that change orders: (a) be in writing, (b) state the scope of any changes in the work, as well as the time and cost impacts, (c) include the party responsible for the change, and (d) be signed by the owner, architect and contractor.

**Project Scheduling & Liquidated Damages.** From the information gathered to date, it appears as though the residential real estate market has been the hardest hit by the Chinese Drywall epidemic; however, the full impact on commercial projects is yet to be seen. Homeowners are going to want the remediation completed as soon as possible so they can return to their homes and normal lives, and to limit the costs of relocation; whereas, commercial owners are going to require timely completion in order to ensure the health of their workers and to get back to business in an already tough economic climate. Risks associated with project scheduling can be allocated through a "time is of the essence" clause, making a failure to timely perform into a material breach of the contract. In order to provide both parties with some measure of certainty in the event of a failure by contractor to timely perform, a carefully drafted liquidated damages clause should be included in the construction contract based upon the amount of damages that the owner will incur as the result of the contractor's failure to timely complete its work.

In summary, because Chinese Drywall remediation is going to involve issues and risks not commonly thought of in traditional negotiations, industry form contracts cannot properly protect the parties from the realities at issue, during and after such remediation. Accordingly, an attorney who specializes in construction should be consulted before entering into any Chinese Drywall remediation construction contract.

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