

SYNTHETIC STUCCO UPDATE: 1999

By Daniel K. Bryson

There are many areas of disagreements in EIFS related litigation. However, there is no dispute that it has become a cottage industry spawning hundreds of law suits throughout the Southeast. In the fall of 1998, in New Hanover Superior Court, an EIFS case was tried before a jury for 6 weeks before settling.¹ The “*Pepper*” trial demonstrated what the parties instinctively understood before trial; namely, that the cases are virtually untriable and prohibitively expensive.

Much has been learned since widespread water intrusion problems were discovered in Wilmington, North Carolina in the fall of 1995 and since the *Pepper* trial. Extensive legal research has been performed by a number of excellent law firms on numerous pertinent issues. On May 14, 1999, an Advanced Synthetic Stucco Update Trial and Beyond CLE presentation occurred at the NC Bar Center. That seminar focused on trial issues and the various legal theories being presented by the various parties. That CLE did not focus on the details of the factual dispute. For an excellent discussion in that regard, see last year’s CLE materials pertaining to the synthetic stucco dispute.² However, a brief synopsis of the parties liability positions can be summarized in the following rap which was penned by a frequent mediator of these cases:

The Manufacturer says, “My stuff’s all right.”
The Builder says, “Applicator failed to put it on right.”
The Applicator says, “I did the best I could.
Y’all know that rot mighta’ come with the wood.”

Everybody knows that the windows might leak,

¹*Kent Pepper and wife, Martha Pepper (Plaintiffs) v. Lancaster Homes, Inc.; Prime South Construction, Inc.; and Sto Corporation (Defendants) and Lancaster Homes, Inc. (Third-Party Plaintiff) v. Western Cedar Roofs, Inc.; The Coastal Window & Door Center; and Lincoln Wood Products, Inc. (Third-Party Defendants)*, New Hanover County Superior Court, 96 CVS 3992.

²See NCBA CLE materials, “Stucco Litigation - A Complete Perspective,” April 17, 1998, Greensboro, North Carolina.

And if the kick-outs ain't right then the Roofer's in deep!

Don't you worry - just give it to old slick,
We'll see if we can get your case settled real damn quick!³

CURRENT STATUS OF DISPUTE

Currently, hundreds of individual EIFS related lawsuits are pending in North Carolina. Typically these cases involve some combination of the general contractor, applicator, subcontractor, EIFS manufacturer, window manufacturer and roofer.⁴ The cases typically settle. It is estimated that approximately 250 EIFS related cases have settled in North Carolina. A rough estimate of the total value of the settlements is \$15 million since 1995. It appears that the number of individual homeowner cases being filed in North Carolina has begun to level off. However, regardless of what happens with the class action, it will take a minimum of two more years to deal with all of the cases.

CURRENT STATUS OF CLASS ACTION

Whether the dispute involving EIFS is appropriate for class action resolution is an issue of sharp debate. Certainly, the manufacturers vigorously dispute the plaintiffs' class action premise; namely, that the product is defective. Currently, the class action is scheduled to begin trial with defendant Dryvit the week beginning October 4, 1999 in Johnston County Superior Court before Business Court Judge Tennille.⁵ The Court recently ruled on several significant motions pertaining to the class. The most significant

³Reprinted without John Aldridge's permission.

⁴It is not terribly uncommon to see other third-party defendants, such as real estate agents, developers, painters and framers.

⁵*William Arthur Ruff and wife, Barbara Ann Ruff; Peter T. Brown and wife, Marlee Murphy Brown; Joan Bozeman; Robert K. Pentz; Ernest L. Liboria and wife Lois P. Liborio; Mary Frances Dillon; Don Clark and wife, Patricia A. Clark; Andrew J. Hutchinson and wife, Carol A. Hutchinson; Miller Homes, f/k/a Rustic Homes of Wilmington, Inc.; March Harbour Golf & Yacht Club Interval Association, Inc.; and Edward A. Dowd and wife, Leah Dowd (Plaintiffs) v. Parex, Inc.; Sto Corp.; W.R. Bonsal Company; Continental Stucco Products; Senergy, Inc.; Thomas Waterproof Coatings Company; Dryvit Systems, Inc.; United States Gypsum Company; and Shields Industries, Inc. (Defendants), New Hanover County Superior Court, 96 CVS 0059.*

motions were the defendant manufacturer's motion to decertify the class and numerous individual homeowner motions to allow late opt out from the class.

A. Motion to Decertify

The Court denied the motion to decertify in a June 1999 decision. In summary, the manufacturers argued that changed circumstances mandated decertification of the class. Namely, the manufacturers contended that discovery had revealed that the vast majority of water intrusion problems occur through poor flashing details or leaky windows. The manufacturers contended that they cannot be blamed for these problems. They further contended that the argument that EIFS is defective because it fails to weep water is also flawed because of other building code permitted claddings that provide no means for weeping water.

In his order the judge decided to submit to a jury the issues of whether the product is defective and whether there was a failure to warn. However, the judge appeared unpersuaded at oral argument as to plaintiffs' counsel's proposal to handle the damages aspect of the trial should a jury find liability. Certainly the extent of damage varies widely with every house. Further, and of critical importance, should homeowners receive damages for spot repairs on certain portions of their house or damages sufficient to entirely reclad their house? Further, if the entire house is reclad, what is the appropriate cladding? The costs among the various cladding vary. Cladding options include brick, cedar shake, stone, hardiplank, vinyl, hard coat stucco, or a combination of the foregoing. The manufacturers argue that they would be denied due process if they are not allowed to contest the validity and extent of every claim for damages.

There is also sharp disagreement as to how potential reclad/repair responsibility would be paid. The manufacturers claim to have insufficient resources to pay for every EIFS homeowner to reclad. The other parties in the dispute (general contractors, applicators, etc.) are unwilling to contribute without being involved in the class action as party defendants. However, Judge Tennille denied the motion to allow third parties into

the class action. According to Tennille, such an action would make the class unmanageable resulting in discovery into the “next century.”

B. Motion for Late Opt-Out

Homeowners not wishing to be associated with the class action were required to opt-out, in writing, by October 24, 1997.⁶ Failure to opt-out by that date meant that the EIFS homeowners were members of the class action regardless of their actual knowledge. Since October 24, 1997, as a result of media reports and the discovery of water intrusion problems in their homes, numerous homeowners (who had no knowledge of the class action) have filed individual civil actions against a variety of parties including the manufacturers. These suits necessitated the filing of motions to enlarge the time within which to opt-out of the class action. Basically, the standard is excusable neglect and whether the parties in the class action (plaintiffs and defendants) would be unduly prejudiced by allowing the late opt-outs. During oral argument, plaintiffs’ class counsel opposed the motion by several hundred individual homeowners but admitted no prejudice if the court were to allow the late opt-out. The manufacturers agreed with the individual homeowners’ argument that all parties, such as the general contractor, should be involved in the litigation, but argued that decertification of the entire class, rather than late opt-out was the appropriate remedy. The Court allowed plaintiffs’ motion and stated that it would “permit those homeowners who have filed a motion to opt out as of the date of this order to opt out of the class provided they complete and file with the Clerk of Court a statement in the form attached hereto as Exhibit A within thirty (30) days.” Thus the deadline to opt out of the class expired again in July 1999. It remains to be seen, if there is a settlement, whether homeowners will be able to reject the settlement and in essence opt out a final time.

⁶Opt-out date was established by Class Notice.

REPORTED EIFS RELATED CASES

There are several reported, or significant, decisions and cases that directly relate to EIFS. Several cases are also on appeal.

1. Alwart v. State Farm Fire & Casualty, N.C. App., 508 S.E. 2d 531 (1998)

Summary: No coverage for homeowners under homeowner's insurance policy.

The facts of this case are the typical EIFS dispute. The homeowner's sought coverage under their homeowner's policy with State Farm Insurance. State Farm denied coverage arguing no coverage for defective construction or materials. The homeowners argued that "ensuing losses" were covered. In other words, the "defective" EIFS or shoddy workmanship may not be covered, but about the rotted wood underneath the EIFS with was not defective. The argument was that this type of loss was "ensuing" and should be covered.

In upholding the trial court's denial of coverage, the Court of Appeals held that the "ensuing loss" contemplated by the policy had to stem from a covered event. In other words, since defective EIFS or shoddy construction is not covered, the ensuing loss of rotted wood is not covered. However, if for example, the loss had originally been from a fire (which is covered), any ensuing loss would have been covered. i.e., water damage to property sustained from putting out the fire. The North Carolina Supreme Court denied the petition for discretionary review several weeks ago.

2. Ruff, et ux. v. Parex, et al., N.C. App. 508 S.E. 2d 524 (1998).

Appeal was taken by the manufacturers from Judge Tennille's denial of their motion to add third parties to the class action. The manufacturers' motion argued that other parties, such as general contractors, EIFS subcontractors, window applicators, etc. should be joined to the class action. In denying the motion, Judge Tennille stated that he had no discretion to change the class as originally constituted. Further, addition of the parties would create unmanageable chaos. Although the Order was interlocutory, the Judge agreed that it affected a substantial right so that an automatic appeal could proceed.

In a somewhat cryptic but succinct decision, the Court of Appeals stated that the Judge did have discretion to make a decision, had failed to exercise it, and should exercise it before the case was ripe for judicial review. The Court of Appeals suggested in dicta that the Judge could deal with his manageability concern by allowing the motion to join third-parties, then severing them out pursuant to Rule 14. In Judge Tennille's June 1999 order, he decided not to allow the third party claims, thus there was no severing to be considered.

3. Amaker v. Duffy Realty & Building Company, et al., NC App., COA98-1559.

The Amaker case is currently on appeal and involves the interpretation of N.C.G.S. § 1-50(a)(5), the Statute of Repose for Improvements on Real Property. The plaintiffs filed their lawsuit within six years of purchasing their home. The builder moved for summary judgment on the ground that the plaintiffs were barred by the applicable statute of repose. The statute reads:

No action shall be brought more than six years from the later of the specific last act or omission of the defendant giving rise to the cause of action or substantial completion of the improvement.

The trial court granted Summary Judgment for the defendant builder and the plaintiffs appealed. The arguments on appeal are relatively straightforward. In their complaint, the plaintiffs alleged that the defendant builder had breached the implied warranty of habitability. Plaintiffs contend that the implied warranty of habitability arose when the house was sold to them by the defendants. As such, the act of sale is a "specific last act giving rise to plaintiffs' causes of action.

The defendant builder, on the other hand, argues that the house was substantially complete more than six years before the filing of the lawsuit, and that the act of sale is not an act giving rise to the plaintiffs' claims. The defendant argues that the owner of a residence can use a house for its intended purpose when the responsible governmental

agency has issued a final certificate of complaint. They further argue that, at the latest, substantial completion of a residence in North Carolina occurs when a certificate of compliance has been issued because an owner can then use the property for the purpose for which it was intended.

A companion case to Amaker, entitled Nolan v. Paramount Homes, et al., No. COA 98-1352, is also before the Court of Appeals. The Nolan case involves substantially the same issues before the Court in Amaker. To date, the Court of Appeals has not specifically ruled on the issue of whether the act of sale is an act within the meaning of N.C.G.S. § 1-50(a)(5)a. The Court of Appeals' decisions in both these cases should provide some guidance on what is now a somewhat murky area of North Carolina law.

4. Monson v. Paramount Homes, Inc., N.C.App. COA 98-463.

The Monson case also involves the interpretation of N.C. Gen. Stat. § 1-50(a)(5)a, but involves a different issue from the one presented in the Nolan and Amaker cases. In Monson, the homeowner sued the general contractor in August, 1996. The house had been completed in late 1990.

In October, 1997, Paramount filed a third-party complaint against Carolina Builders Corporation, asserting indemnity and contribution claims. In its complaint, Paramount asserted that plaintiff had contacted Carolina Builders in the spring of 1994 to report that several windows and glass doors at the house were leaking, fogging, and otherwise malfunctioning, and that Carolina Builders had performed repair work in response to the plaintiff's call.

Carolina Builders moved to dismiss the third-party complaint pursuant to 12(b)1) and 12(b)(6) of the North Carolina Rules of Civil procedure. The motion was granted, on the grounds that Paramount's claims against Carolina Builders had been filed after the applicable statute of repose had expired.

In their brief, Paramount argued to the Court of Appeals that their third-party complaint was timely filed within six years of Carolina Builders' specific last act or omission giving rise to Paramount's claims. Specifically, Paramount argued that Carolina Builders' specific last act was the alleged repair or replacement of defective windows in 1994. Paramount asserted that since the alleged repairs were performed within six years of the filing of their third-party complaint, their third-party complaint was timely filed.

Third-party defendant Carolina Builders argued that the six-year repose period began upon the substantial completion of the house in August 1990, and not from the 1994 repairs, because: 1) Paramount's allegations tied any conduct by Carolina Builders giving rise to Paramount's breach of contract, breach of warranties, and negligence claims to the original 1990 construction of the House and 2) any holding that subsequent remedial measures can be used to restart the running of the statute of repose would violate North Carolina public policy- as expressed in N.C. R. Evid. 407 - which seeks to encourage repairs and subsequent remedial measures.

5. Medlin v. FYCO, Inc. and M. Frank Young, Guilford County Superior Court, 96 CVS 11370.

This EIFS related case was tried to a jury verdict over a two week period beginning on October 26, 1998. The homeowners presented evidence only against the defendant builder. The builder argued that it was an innocent victim and that the

homeowner should seek recovery from the responsible EIFS manufacturer. The jury returned a verdict for the homeowner for \$187,305 plus interest and costs. The case has been appealed. The builder's insurance carrier is also disputing coverage.

6. Thornton v. Jones Realty & Construction Corporation, (defendant), and Mountcastle Construction Company, Inc., (third-party defendant), Case No. CL96-76, Circuit Court of the Courts of Goochland, Virginia.

This EIFS related case was tried to a jury verdict from August 17 to August 18, 1998. Jones Realty was the general contractor. Mountcastle was the EIFS applicator. The homeowner filed against the general contractor, who filed a third-party complaint against the applicator. Although, the jury returned a verdict of \$77,166 for the homeowner against the general contractor, the jury found in favor of the EIFS applicator on the third-party claim by the general contractor. Both the Medlin and Thornton cases indicate that the shortest and most efficient route to resolution for a homeowner is to proceed only against the general contractor if the case has to be actually tried.

7. Mayer v. Sto Corp., No. 95-2-04168-5 (Pierce County, Washington).

In this case the general contractor, who also was the owner of the EIFS clad home, sued Sto and other parties such as the window manufacturer and the EIFS subcontractor applicator. All parties settled except Sto prior to trial. Following a three week jury trial, the jury found in favor of Sto. Plaintiff appealed. The primary basis for the appeal was that Sto had failed to disclose a damaging memorandum written by a key Sto employee which discussed "inherent flaws in the EIF wall system". This memo was discovered by the plaintiff after trial.

In a decision dated September 10, 1999 the Washington Court of Appeals agreed with plaintiff and granted a new trial. A copy of this significant decision is attached to

this manuscript. The Court held that the “statements in his memorandum are essentially admissions that the product is defective.”

8. Lienhart V. Dryvit Systems, Inc., No. 5:99-CV-470-B(3) (E.D.N.C., filed June 25, 1999).

This is a class action lawsuit involving an exterior cladding system known as Fastrak system 4000. Fastrak System 4000 (“Fastrak 4000” or “DEFS”) is a direct applied exterior finish system developed, designed, manufactured, marketed, distributed, promoted and sold by Dryvit Systems, Inc. The plaintiffs allege that Dryvit developed, designed, manufactured, marketed, distributed, promoted and sold Fastrak system 4000 with full knowledge it was defective in design and would fail to perform as warranted.

On June 25, 1999, plaintiffs filed their Complaint in Wake County Superior Court. On July 21, 1999, defendant Dryvit Systems, Inc. (“Dryvit”) filed a Notice of Removal in the United States District Court for the Eastern District of North Carolina. On July 28, 1999, Dryvit filed its Answer to the Class-Action Complaint and Motion to Certify Class. On August 9, 1999, Dryvit filed its Third-Party Complaint, impleading 75 additional named defendants and 125 John Does. These Third-Party Defendants are general contractors, EIFS applicators, window manufacturers and roofing subcontractors. In response, plaintiffs filed the instant Motion to Strike Dryvit’s Third-Party Complaint, and alternative Motion to Sever or for Separate Trials, which is presently before the court. In addition, plaintiffs will shortly file its motion to certify the class with the court.

Defendant Dryvit is the largest producer of exterior insulation finish systems (“EIFS”) in the United States. The term EIFS generally refers to the use of insulation board adhesively or mechanically attached to a structure’s framing, over which is applied a polymer-based or polymer-modified base coat with a fiberglass reinforcement mesh and an acrylic finish coat. Direct-applied Exterior Finish Systems (“DEFS”), including Fastrak, are different from EIFS in that the coatings and mesh are applied directly to the sheathing. Unlike EIFS, DEFS includes no insulation component. Defendant Dryvit

specified “Dens-Glass Gold” sheathing, which is manufactured by Georgia-Pacific, to be used as the sheathing component of Fastrak. The sheathing is mechanically attached directly to a structure’s framing in a direct-applied exterior finish system, and adhesive attachment is not an option. The “direct attachment” of the sheathing to the structure’s framing, rather than adhesive attachment of EPS board to a substrate affixed to a structure’s framing, is one of the primary differences between EIFS and DEFS.

BOOKS and PERIODICALS

Listed below are a sampling of excellent books and periodicals that discuss EIFS:

1. Exterior Insulation and Finish System Design Handbook, Robert G. Thomas, Jr., (1992 ed). This book was written by Dryvit’s former Technical Services Director.
2. Water In Exterior Building Walls, Problems and Solutions, Thomas A. Schwatz, editor, ASTM, STP 1107 (1992). This book contains articles by many of the experts in this dispute.
3. Development, Use and Performance of Exterior Insulation and Finish Systems (EIFS), Mark F. Williams and Richard G. Lampo, Editors, ASTM, STP 1187 (1995).
4. Exterior Insulation Finish Systems (EIFS), Materials, Properties and Performance, Peter E. Nelson, Richard E. Kroll, Editors, ASTM, STP 1269 (1996).
5. Water Leakage Through Building Facades, Robert J. Kudder, Jeffrey L. Endly, Editors, ASTM, STP 1314 (1996).
6. Exterior Insulation and Finish Systems, Current Practices and Future Considerations, Mark F. Williams and Barbara Lamp Williams; ASTM Manual Series; MNL 16, ASTM Publication Code Number (PCN) 28-016094-10 (1994). This book was written by the general contractor’s primary expert.
7. Moisture Control Handbook, Principles and Practices for Residential and Small Commercial Buildings, Joseph Lstiburek, John Carmody (1994). This book is written by an expert who has testified for homeowners.
8. The Ten Books on Architecture, Vitruvius (1914). Vitruvius is a Roman architect who wrote at the time of Augustus Caesar and warned of moisture intrusion in stucco walls.

9. North Carolina State Building Code, Residential, 1992 -1998 editions, North Carolina Building Code Council and North Carolina Department of Insurance. The Building Codes contain numerous applicable provisions in this dispute.

10. Walls and Ceilings, The voice of the Industry since 1938. This monthly magazine contains numerous articles and commentary about the EIFS Industry. It is fascinating reading. If you subscribe and agree with my assessment, then you are spending too many hours working on EIFS cases.

WEBSITES

There are a number of parties who are communicating information about EIFS through the internet. A sampling of those websites are as follows:

www.EIFSlaw.com

EIFS Legal Network is a web site by attorneys handling cases for homeowners.

www.novashoc.org

Web site of the Northern Virginia Stucco Homeowners Coalition. Features news highlights about EIFS, information about detecting EIFS problems, and extensive information about EIFS related litigation.

www.stocorp.com

Web site of the Sto Corporation, an EIFS manufacturer.

www.dryvit.com

Web site of Dryvit Systems, Inc., an EIFS manufacturer.

www.parex.com

Web site of Parex, and EIFS manufacturer.

www.durock.com

Web site of Durock Alfacing International, Ltd.

www.usg.com

Web site of the USG Corporation. Offers news about EIFS and information about water-managed synthetic stucco systems.

www.eifs.com

Web site of CMD Associates, Inc., a consulting firm specializing in EIFS.

www.eifsfacts.com

Web site of the EIFS Industry Members Association. Features an industry response to the Dateline NBC report.

R.V. Buric Construction Consultants

Address and contact information.

www.gahi.com

Web site of the Georgia Association of Home Inspectors.

www.awci.org

Web site of the Association of Wall and Ceiling Industries. Features contact information on EIFS inspectors and “EIFS mechanics.”

There is currently pending in the North Carolina legislature several bills which could significantly impact this dispute. Copies of House bills 1254 and 1256 are attached to this manuscript. House bill 1256 is an “Act to Create a Legislative Study Commission to Study the Need for Increased Regulation of the Homebuilding Industry.” There is a very good likelihood that these issues will be tied up in the legislature for some time. I have also heard that the current statutes of repose and limitation may be examined.

FUTURE OF THE DISPUTE

What will the status of the dispute be on *September 25, 2000*? I offer the following predictions:

1. Shortly before trial of the class action on October 4, 1999, a settlement was reached similar to the Senergy settlement of \$4.00 per square foot.⁷ Although, the latest information is that future settlements may be in the \$6.00 per square foot range.

⁷This is a very gross simplification of the settlement criteria in the Synergy settlement protocol.

2. Dozens of individual lawsuits continue to work their way through the civil litigation process. Several trials occurred in the Spring of 2000, resulting in homeowner verdicts.

3. Individual suits continue to proliferate in other southern states, such as South Carolina, Virginia and Georgia. In addition, suits involving condominiums and commercial businesses will increase. For example, in March 1999, McDonald's Corporation filed suit against Dryvit, Parex, a general contractor, and several EIFS applicators for moisture intrusion problems experienced on 65 restaurants.⁸

4. Unable to afford the numerous claims being made, several of the smaller EIFS manufacturers, little more than bucket shops, declared bankruptcy.

5. "Drainable" EIFS continues to become the industry standard. Although barrier EIFS are not "officially discontinued," only drainable EIFS are sold for residential construction by the manufacturers.

⁸*McDonald's Corporation v. Ratley Construction Co., Inc.*, No. 99-CVS-981 (New Hanover County, North Carolina).