

National Warranted Class-Action Repair Settlement for the Inspection, Remediation and Warranty of Defective Drywall Properties (proposed)

Draft by

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Overview

The homeowner victims with defective drywall desperately need a turn-key solution to the financial disaster they are facing. The timely benefits that could mitigate the crisis are possible within the context of a voluntary national settlement based on the repair and long-term warranty of these embattled homes. This paper provides descriptions of a practical working model of a settlement that could be implemented in a matter of months with the cooperation of the primary domestic defendants, their insurers and the lead government research agencies (Consumer Products Safety Council and EPA).

Executive Summary

Defendants and plaintiffs in this crisis are both victims of the foreign based parties that created the drywall products that led to the crisis. Those responsible parties are unlikely to contribute to any settlement until exhaustive legal, political and public relations pressure have been amassed to generate the sufficient level of pressure necessary to produce actual cash contributions to the victims. That level of pressure is likely to take years, which the majority of the affected homeowners simply can't financially survive.

For many of those homeowners with defective drywall, bankruptcy, foreclosure and financial ruin will be the final result of this crisis. Many homeowners have already experienced this very fate. The current national recession and depressed real estate market have accelerated the pace of the crisis, further burdening these homeowners.

Builders, developers, installers, retailer, distributors and other parties are also exposed to potential ruin by this defective product, once considered a commodity in the building industry. With the foreign manufacturers absent, the domestic defendants, primarily the builders are at risk of being burdened with the full cost of the disaster. A dormant building market, restricted credit lines, severely devalued assets and weak balance sheets already have taken their toll on builders, both large and small. Forcing the builders and other defendants into financial ruin will accomplish nothing for the homeowners. Further unemployment and destabilization in the building sector will follow.

It is also worth considering that more than 90% of the homes believed to contain some amount of defective drywall are located in areas that are already suffering from record property devaluations. Adding tens of thousands of toxic properties to the real estate pool in these areas will result in continued downward pressure on neighborhood values, which affect all homeowners regardless of whether they have defective drywall or not. The financial loss on all property values in these areas, regardless of defective drywall, will be in the billions of dollars if this problem is not reversed.

This settlement proposes to balance the burden of the full remediation cost fairly across all defendants, including the foreign manufacturers, despite their absence. By portioning off the unfunded part of the settlement cost through special refinancing by the existing lender, the home can be repaired and inhabited in the least amount of time possible. Recovery of the unfunded portion of the settlement can continue to be vigorously pursued without further delaying the repair and occupation of the home.

Banks, being the primary default owner, are becoming aware that they have a truly “toxic risk” within a “toxic asset” that would be much better dealt with through flexible terms and specialized mortgage modifications. This allows the majority of homeowner who are unable to personally fund the balance of the repairs to obtain financing under favorable terms to minimize their cash flow burden.

Assisting an afflicted homeowner by allowing mortgage forbearance and partial financing of the repair costs will ultimately produce loan loss reductions that will be measured by the lenders in multiples.

The alternative to a settlement for these lenders will be tainted property liquidation recovery rates of 15% or less. In some states, lenders may be responsible for the “clean up” of these homes and restricted from liquidating a known “toxic” asset.

Funds that may be eventually acquired from the missing foreign defendants can be equitably distributed to the original homeowners in the future, even if they no longer own the home. Lenders could require repayment or reduction of the repair cost portion of the modified mortgage when these funds are distributed. This would provide the lender with further securitization of the risk.

A remediation-based settlement of this nature will require a government-agency accepted inspection and repair program, backed by a third-party national warranty program. The Consumer Products Safety Commission is already considering existing inspection and repair protocols to incorporate in to their recommendations. A nationally recognized, A.M. Best “Excellent” rated insurer is in the process of creating a 10-year, \$100,000 limited warranty to back the inspection and remediation program.

This inspection, repair and warranty settlement model has been successfully implemented in the recent past on a smaller, but equally complex national construction defect issue, which was developed by the company drafting this proposal.

Past experience with similar construction defect issues has proven that a well executed and warranted remediation program can accelerate the solution process and restore property values. By stabilizing the market for these homes, tens of thousands of these homeowners will be capable of staying in their home or selling it at fair market value.

Considering the anticipated scope of defective drywall problem, this solution strategy could save billions of dollars in additional losses, stabilize the resale

market and prevent tens of thousands of homeowners from suffering financial ruin. Time is of the essence.

Structure of a Warranted Class-Action Repair Settlement

The primary benefits of a voluntary settlement would be the ability to provide a timely, structured and equitable distribution of the settlements financial burden across all parties. By setting aside legal interpretations, jurisdictional disputes and policy language, defendants can participate without exposure to excessive legal costs or inflated jury awards for those Claimants within the settlement. Legal delays and fees are minimized, while the vast majority of the funding is used to actually fix the problem.

Single Home Example of a Possible Settlement Scenario

(all figures and dollar amounts are for example purposes only)

Projected Repair Cost = \$15.00/sq. ft. of total drywall in the home

Average Home Cost Projections:

Ratio 2.5:1 - Total drywall sq. ft. to total heated sq. ft. of home

-Average 2,500 heated sq. ft. home = 6,250 estimated sq. ft. of drywall

-6,250 sq. ft. at \$15/sq. ft. = **\$93,750**- Total Remediation Cost

-6,250 sq. ft. at \$7.50/sq. ft. = \$46,875- Net contribution from settlement

-6,250 sq. ft. at \$7.50/sq. ft. = \$46,875- Remaining funds required

- 6,250 sq. ft. at \$2.50/sq. ft. = \$15,625 for:

- \$3,600 for up to six required inspections and testing

- \$2,180 for 10-year warranty (\$100,000 limit)

- \$6,250 for legal fees

- \$2,000 for settlement administrative costs
- \$1,595 for National Notice program
- Special mortgage modification to finance - \$46,875
 - \$46,875 for 30-Yr. Fixed rate at 5%APR = \$260 monthly

Division of Costs for Defendants Based On Previous Example

Note: Contribution from defendants for example purposes only. Cost percentages will be distributed based on settlement negotiations, then standardized by defendant type.

<u>Defendants</u>	<u>Percentage</u>	<u>Equals /Sq.Ft.</u>	<u>Payout</u>
Builder & Insurer	15%	\$2.25	\$14,062.50
Developer & Insurer	10%	\$1.50	\$9,375.00
Installer & Insurer	12.5%	\$1.75	\$9,375.00
Retailer & Insurer	10%	\$1.50	\$9,375.00
Distributor & Insurer	10%	\$1.50	\$9,375.00
Homeowners Insurer	10%	\$1.50	\$9,375.00
Admin./Insp/Warranty/Notice	-10%	(\$1.50)	(\$9,375.00)
<u>Legal Fees</u>	<u>-7.50%</u>	<u>(\$1.00)</u>	<u>(\$6,250.00)</u>
Totals for Repairs	50%	\$7.50	\$46,875

By participating in this voluntary settlement, homeowners would still be paying for the deficit left by the absence of the foreign defendants. However, if funds are eventually extracted from these parties or any other source, those funds would be distributed to homeowners on a per sq. ft. basis to offset the cost burden that they paid or financed to repair the home. This distribution would extend to the Claimant that was the owner of the home and funded either directly or through financing, the repair of the home within the settlement.

Settlement Benefits Based on Links to Participating Defendants

Since numerous defendants will be involved with the settlement, the Claimant would be required to provide evidence of a direct link to each specific defendant. This will be simplified for many Claimants by patterns that will emerge between builders, developers, installers, suppliers/retailers and distributors. If a Claimant builder is in the settlement, then tracing additional relationships will be simplified.

Additionally, the builder may also choose to assume the liability of any number of the other defendants. For example, if the builder was also the developer and the installer, then they would assume the settlement percentage of those defendant categories. However, it will be up to the builder to decide what additional categories they wish to assume in addition to the builder percentage. Obviously the more defendant categories that are satisfied, the more likely the Claimant is to participate and accept the benefits of the settlement.

The settlement benefit to an individual Claimant will be directly related to the number of defendants that match up with the Claimant's home. Evidence of this link with each defendant cannot be overly burdensome to the Claimant and reasonable standards of proof will be established.

The repair cost deficit remaining after the settlement contribution are made by each qualified defendant will be the responsibility of the Claimant to fund. Claimants will retain the right to sue defendants that choose not to participate in the settlement. Additionally, separate class-action suits may be organized against these holdout defendants.

Mortgage lenders that join the settlement will be familiar with the required terms and conditions set forth in the settlement. Non-participating lenders will have to be approached by the Claimant to secure financing or the claimant will have to pay for the balance of the repairs with their own funds. Mortgage holders are not defendants, but would be bound by the settlement agreement if they choose to participate.

As with any class-action, Claimants would have the option to “opt-out” of the settlement and pursue individual litigation. Defendants would also have a choice of joining the settlement or fighting the litigation independently. However, penalties would be applied to defendants that delayed joining the settlement until a later date.

Specific Benefits for the Claimant

Step One: Initial Defective Drywall Certification Inspection

(Provided as a benefit of the settlement to Qualifying Claimants at no cost)

This Defective Drywall Certification Inspection protocol requires the following elements (based on initial protocols currently being applied in the market, but eventually based on the recommendations from CPSC or EPA):

- Confirmation of the presence of Qualifying Defective Drywall using XRF X-ray testing with photo documentation of test locations
- Photo evidence showing markings or labels consistent with Qualifying Defective Drywall
- Evidence that more than XX% of the drywall in the home is Qualifying Defective Drywall
- Identification photo of the front of the home
- Photos of the interior of the home by room
- Net sq. ft. measurements of drywall by room
- Total sq. ft. of drywall in the home
- If less than XX% of the drywall is Qualify Defective Drywall, then a room by room determination of the location of the Qualifying Defective Drywall will be considered
- Homes with less than XX% Qualifying Defective Drywall will be required to pay for XX% of the inspection and warranty cost.

- Homes with less than X% Qualifying Defective Drywall will be required to pay the full cost of the inspections and warranty. Additionally, these Limited Claimants may only receive settlement compensation based on the confirmed square footage of Qualifying Defective Drywall.

Step Two: Remediation and Oversight Inspections

1. Claimant chooses a Certified Drywall Remediation Contractor. These companies must be licensed general contractors within the state that they will be working. They must pass a Defective Drywall Remediation Certification program. They must provide a three-year workmanship warranty for the craftsmanship aspects of the remediation that will be completed on the home.
2. The homeowner contracts directly with the Certified Drywall Remediation Contractor.
3. Repair funds will be drawn out of an escrow account managed by the settlement administrator based on specific construction stages that will be determined to be completed by the Certified Defective Drywall Inspector or Consultant. The fees of the inspector will be paid for by the administrative fund of the settlement.
4. Upon completion of the repairs, a Drywall Clearance Inspection will be completed, which will include:
 - a. Verification of the adequacy of the quality control inspections performed during the repair process including inspection of the full drywall removal, chemical off-gas suppression application, HEPA clean down and refit.
 - b. Off-gas testing using the protocols establish to qualify for the warranty

- c. Photographic documentation of the finished condition of the home at the time of completion.
 - d. Punch list of minor items of touch up or repair.
 - e. Pass or fail determination for warranty authorization.
 - f. Pass or fail determination of off-gas clearance of personal items returning to the home.
5. 10-Year Drywall Clearance Warranty is issued.
- a. Fully transferable to a new owner
 - b. Renewable coverage to full 10-years at anytime during the term of the initial warranty.
 - c. \$100,000 full term limit with upgrade options to \$500K
 - d. A.M. Best “Excellent” rated underwriter
 - e. Claims benefits based on accepted off-gassing standards to be determined by the appropriate governing body (CPSC, EPA, etc.)

Other Consideration Supporting a Warranted Remediation Settlement

Public Benefits of Settlement

- Stabilization of Real Estate Values
- Non-Claimant Value (relief of neighbor damages)
- Economic Stimulant to Depressed Construction Market
- Economic Stimulant to Depressed Geographic Area
- Collection of Damage Data To Support Compensation Efforts Against Missing Defendants (Knauf, Chinese and Others)

Benefits to Participating Defendants

- Predictable Exposure Per Home
- Substantially Reduced Litigation Costs
- Reduced Settlement Cost Per Home
- Closure at Class-Action Termination