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The Rise of Aggregate Settlements and MDLs: Happy Together

By Edgar C. Gentle, III, Esq.

Mass settlements evolved from large class actions to large aggregate settlements, resulting to the rise of multidistrict litigation ("MDL") as the new popular mass case settlement forum. This article presents the anatomy of aggregate settlements, together with the mechanics and ethics of carrying them out successfully, and addresses the problem of organizing and managing mass case Plaintiffs' common benefit lawyers, and the role of special masters in mass cases.

I. The Demise of Class Action Settlements and The Rise of MDL Aggregate Settlements

A. 1966 Was A Banner Year for Mass Cases

(i) Rule 23 becomes book-of-the-month club and attracts mass tort settlements until killed by *Ortiz and AmChem*.

In 1966, Rule 23 of the Federal Rules of Civil Procedure was modified by allowing an opt-out class and eliminating the opt-in requirement. The rationale was to allow the "prosecution of those class actions involving an aggregation of small individual claims, where a large number of claims are required to make it economical to bring suit." *Shutts, 472 U.S. at 812-813*. Ironically, however, the Rule Advisory Committee in its 1966 notes did not think mass tort personal injury cases were "ordinally not appropriate" for class treatment.

At first blush, the new opt-out class action attracted mass settlement interest, on both sides of case. It would help the Defendant preclude further litigation, as class actions are a recognized exception to the prohibition against non-party preclusion, and the settlement class could generate res judicata not achievable by piecemeal litigation. *Taylor v. Sturgell, 533 U.S. 880, at 894 (2008)*. The promise of a conclusive end to litigation provided strong incentives for defendants' and plaintiffs' lawyers. For defendants, the settlement class held out the hope of a more certain grasp on the size of their liability and a defined end point to further litigation costs. On the other side of the ball, plaintiffs' lawyers were able to facilitate the defendant's desire for issue preclusion in return for compensation for class claimants and themselves.

There were early successes in the use of class actions in settling mass cases, with the most prominent being In re *Agent Orange, 818 F.2d 145 (2d Cir. 1987)*. In the wake of *Agent Orange*, the Courts appeared to drop their resistance to class action settlements, and class actions shifted from litigation

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enablement devices to a global resolution device, resulting in the rise of the settlement class, a class often only created in the context of a proposed settlement, with the class to vanish if the settlement is not approved.

Problems soon surfaced, which ultimately doomed large scale use of the settlement class device. There were fears of disloyalty by class counsel, as they jockeyed for leadership roles in a class action, with accusations of reverse auctions, in which class counsel could promise a small settlement to defendants in exchange for obtaining case leadership. *AmChem, 80 Cornell L. Rev. 1045 (1995)*, John Coffee. It was also suggested that class counsel were incentivized to shape the class in a way that did not ensure the equitable treatment of all claimants, especially future claimants with unknown maladies. Following the Supreme Court's decisions soon echoed these concerns, hobbling the use of settlement classes as global peacekeeping devices.

The first shot across the bow was *AmChem, 52 U.S. 591 (1997)*, which was an attempt by the parties to resolve all asbestos claims related to personal injury liability of the defendants, including those of future claimants with no symptoms. The class was struck down, in part, because the symptom-free individuals lacked notice and representation within the class. Another problem was the Court's finding that individual liability and damage issues predominated to defeat class certification. *Id at 626-627*. Next, *Ortiz, 527 U.S. 815 (1999)* struck down an attempted mandatory class without opt-out rights, but without the defendants filing bankruptcy, as an improper end run around the priority scheme governing creditors in bankruptcy.

In both cases, the Supreme Court expressed concerns about personal injury class settlements binding future claimants due to inadequate representation.

After *AmChem* and *Ortiz*, parties scrambled to design a new process for the global resolution of cases, and turned their eyes to the MDL, where, as a practical matter, cases can be consolidated, usually never to be separated again.

(i) The MDL Statute is enacted, creating Mass Settlement Black Holes.

The theory of MDL in 1966 was simple: to limit the possibility of inconsistent decisions on key questions of law or fact during litigation, which could occur if there are multiple forums deciding related cases. The MDL process, on its face, does not seem to be a candidate for peacemaking in mass cases, because it is so simple:

The MDL statute provides:

> When civil actions involving one or more common questions of fact are pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings ... Each action so transferred shall be remanded by the panel at or before the conclusion of such pretrial proceedings to the district from which it was transferred unless it shall have been previously terminated. ...

So, why are related MDL cases not aggregated for discovery and then sent back to the originating courts when this is complete? Answer: they settle.

The vast majority of MDLs settle, and only few cases settled as class actions after *AmChem* and *Ortiz*. *The Quasi-Class Action Method of Managing Multi-District Litigation, Problems and a Proposal, Silver and Miller, 63 Vanderbilt L R 107 (2010)*. Indeed, only 3% of MDL cases ever go back to the original district. *Judging Multi-District Litigation, NYU L R 2015, Elizabeth Chamblee Burch*.

MDL practice now usually means the transfer of a large number of similar cases to a selected District Court to begin a process leading to a global resolution of the litigation. The transferee judge usually selects lead plaintiff counsel, shepherds a master settlement agreement, and decides the compensation of plaintiffs' counsel. It appears to be a blend of informal aggregation for discovery with active judicial involvement similar to that in the old class action,

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but previously without any legal underpinning.

If the class action settlement is not available in the MDL, what is a Transferee Judge to do after *Amchem*? Rule 23 is now "a mandate of perfection," Elizabeth Crabraser wrote in *The Class Action, 57 Stanford LR 1476*.

The current settlement vehicle of choice is sometimes called a quasi-class action settlement, which, in reality, is an aggregate settlement under ABA Rule 1.8(g). Though the definition of an aggregate settlement is debated, it simply is the settlement of two or more cases with a fixed or capped lump sum of money so that the recovery amount of each settling individual is interdependent with the recovery amount of the others. To resolve the case, there is usually a series of bellwether trials followed by a global settlement. The MDL Transferee Judges are often rewarded for so settling complex disputes with additional MDL referrals. See, for example, the *Vioxx* Settlement supervised by Judge Eldon Fallon and the *Zyprexa (424 F2d 488, at 491-494 (E.D.N.Y 2006)* Settlement supervised by Judge Jack Weinstein.

In reality, the power of the MDL Transferee Judge to delay dispositive motions, dismiss cases, price claims through bellwether trials, and set plaintiffs' lawyer compensation in many ways resembles the power of judicial supervision in class actions helping facilitate MDL settlements. *Toward a Bankruptcy Model for Non-Class Aggregate Litigation, Troy A. McKenzie, at page 986*.

There is a clear tension between, on the one hand, the theoretical workings of the MDL and the right of individuals to exit collective proceedings and litigate alone with, on the other hand, the desire of the Court and the lead lawyers to resolve the cases in one global settlement. Nothing in the MDL statute expressly authorizes MDL Judges to select lead counsel or set their compensation.

This recent practice of quasi-class action settlements greatly reduces the ability of parties to untangle their individual actions from others gathered in the MDL forum and to exit and litigate them individually.

II. Aggregate Settlements: The New Mass Action Resolution Vehicle

A. Fundamental Requirements and Practical Results

Let us now discuss the settlement vehicle you now usually see in MDLs and outside MDLs, following the large-scale demise of class actions: the aggregate settlement. Similar to the MDL statute, the ABA Aggregate Settlement Rule is surprisingly sparse:

> A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere, unless each client consents after consultation, including disclosures of the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement. ABA Rule 1.8(g)

ABA Formal Opinion 06-638 identifies the information that must be communicated to each claimant in order to obtain his or her authorization to settle in compliance with Rule 1.8(g):

- The total amount of the aggregate settlement.
- The existence and nature of all of the claims, defenses, or pleas involved.
- The details of the claimant's and every other claimants' participation in the aggregate settlement, including what each is to be paid.
- The total fees and costs to be paid to the lawyer as a result of the aggregate settlement.
- The method by which costs (including costs already paid by the lawyer as well as costs to be paid out of the settlement proceeds) are to be apportioned among the claimants.

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What does an aggregate settlement typically look like? Below is a table from a presentation by Eliot Jubelirer of Schiff Hardin in San Francisco:

Are These Aggregate Settlements?

1) Lump sum settlement of $1,770,000

2) Lump sum settlement by disease category

5 mesothelioma cases	500,000	($100,000 each)
20 lung cancer cases	500,000	($ 25,000 each)
35 asbestosis cases	350,000	($ 10,000 each)
140 disputed asbestosis cases	420,000	($ 3,000 each)
	$1,770,000	

3) Individual analysis and negotiation with the defendant of the value of each case with a cap on the total.

4) Individual analysis and negotiation with the defendant of the value of each case with no set cap.

The critical part of the aggregate settlement definition is interdependence of the recovery of a group of plaintiffs. Thus, example one above, with a lump settlement to be allocated among a group of plaintiffs, is clearly an aggregate settlement. Same with example two. Same with example three because there is a cap on the total. Example four is not an Aggregate Settlement because there is no cap. If example four is pursued, the Aggregate Settlement rule does not apply, with all of its ethical problems.

In large aggregate settlements, bells and whistles are often added as an incentive to plaintiffs' lawyers to push their clients to agree to the deal and to punish the clients if they don't. Such bells and whistles may very well be unethical.

For example, in the $4.85B *Vioxx* Global Settlement, 85% of the plaintiffs had to agree to the deal or it was off the table. Plaintiff firms had to recommend the deal to all of their claimants to have any of their claimants participate. And, if a claimant did not agree to the deal, his or her lawyer had to withdraw from the claimant's representation, effectively putting the claimant in the cold. If a claimant in an MDL does not agree to a global settlement, where does the claimant go? As we have seen, it is almost impossible to leave the MDL, and what lawyer will help the claimant if, as in *Vioxx*, lawyers with knowledge of the case are required to boycott the recalcitrant claimants?

Unlike in class actions, the Aggregate Settlement Rule greatly empowers the dissident plaintiff, with much time being spent in each aggregate settlement bringing the naysayers into the fold. As a result, there is an ongoing effort to move toward majority rule in approving an aggregate settlement.

See proposed ALI Rule § 3.17 (2010):

> [I]ndividual claimants may, before the receipt of a proposed settlement offer, enter into an agreement in writing through shared counsel allowing each participating claimant to be bound by a substantial-majority vote of all claimants concerning an aggregate-settlement proposal (or, if the settlement significantly distinguishes among different categories of claimants, a separate substantial-majority vote of each category of claimants).

This is not the rule by the ABA, or practically any state

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in the nation.

By contrast, the class action does not include a mechanism for group consensus and limits the opportunities of class members to voice their approval by not opting out or their disapproval by not opting out but by filing an objection. Aggregate settlements allow disapproval by silence while silence means the opposite in a class action settlement. The theory of the class action is that the named class representatives, class counsel, and the court will act as fiduciaries for the class protecting them from unfavorable settlements. *Zyprexa 424 F2d 488*. All of these mechanisms are often in place for an aggregate settlement but individual claimants have much more power. The policy reason for such a dichotomy in bargaining power is a mystery.

B. Aggregate Settlement Mechanics

The rule of the road for every aggregate settlement is to get State Bar approval of it up front. State Bar approval on the back end, if the aggregate settlement goes sour or you have a dissident claimant, is almost impossible to get. Some State Bars are more cooperative than others in approving aggregate settlements as passing muster under Rule 1.8(g).

The themes of successfully carrying out an aggregate settlement are transparency and informed consent. The best approach to a potential aggregate settlement is, first, to get client consent to an attempted Aggregate Settlement, up front before negotiations begin. In drafting the consent, the client should agree that you may reveal information relating to the client's representation to other clients, which is necessary to carry out the rule. Consent is required so as not to violate ABA Rule 1.6(a) respecting unauthorized client disclosures. For a plaintiff firm or firms to do the allocations, instead of having a neutral, such as a special master, do them, may run afoul of ABA Rule 1.7(a)(2) which provides in pertinent part:

> A lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person of by a personal interest of the lawyer.

Having a neutral do the allocation will avoid a conflict of interest that would exist if there is a high risk that your ability to consider, recommend, or carry out an appropriate course of action for one client will be materially limited as a result of your obligations to another client, which is inherent in the aggregate settlement allocation process.

Prior client consent to enter into an aggregate settlement cannot substitute for the requirement of subsequent client consent to the final proposed aggregate settlement award allocations following the disclosures that must be made to the client. *Hayes v. Eagle-Pitcher Industries, Inc., 513 F2d 892 (10th Cir. 1975)*.

How do you handle errors and inaccuracies in the allocation process and the strong possibility that the neutral doing the allocations was unaware of or did not fully appreciate certain damages criteria of one or more claimants? The practical answer is to have a hold back of between 5 and 10 percent, which is revealed, up front, to the participating claimants at the time they are asked to consent to their proposed aggregate settlement amount, and giving all claimants the right to appeal the award, while noting that the award may be adjusted upward only if the appeal has merit.

Some aggregate settlements have tried to penalize claimants so appealing to discourage them. However, in my opinion, this may violate the rule whose theme is informed and free consent. After the appeals have been vetted and any additional awards have been made, any remaining appeals reserve is then ratably paid to all aggregate settlement claimants.

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When an aggregate settlement is presented by one of more law firms to a group of plaintiffs, do the plaintiffs lawyers have an irreconcilable conflict of interest, being incented to close the deal and get their fee, while the client has to decide whether to take or leave the award? That is, in the aggregate settlement approval or disapproval right process, are the dissident claimant's exit rights real or fictitious? One solution to the problem would be to appoint a guardian ad litem to represent the claimants at the time they decide to accept or reject the deal. I have never heard of this being done.

Is it ethical for a court to require or for a lawyer to threaten withdrawal from the client's representation if the client disagrees with the proposed aggregate settlement? The answer appears to be no. See, for example, *DeFlumer v. LeSchack, 200 Westlaw 654608 (N.D.N.Y May 19, 2000)*, and *Tsavaris v. Tsavaris, 244 S 2d 450 (Florida Dis. Ct. Ap. 1971)*. *Vioxx* apparently crossed the line here.

Is it ethical for a defendant to enter into different aggregate settlements with different law firms for the same tort, at the same time while paying claimants who are equally damaged different amounts among firms? This is done all the time with plaintiffs having the same level of damages receiving different award levels based upon the bargaining strength of the law firm representing them. See, for example, *Administration of the 2003 Tolbert Settlement, 60 Ala. C.R. 1249 (2009)*, by Ed Gentle, where Monsanto had two simultaneous $300 million Aggregate Settlements, one for 18,000 Plaintiffs and one for 3,500.

Is there no consequence to the law firm if it can show that the client was not hurt by the firm's non-compliance with the Aggregate Settlement Rule? No, the law firm can forfeit its fees. See, *Burrow v. Arce, 997 So. W. 2d 229 (Texas 1999)*.

C. Mass Tort Client Representation Issues

How hard is it to carry out an aggregate settlement and get 100% plaintiff approval, the obvious safe harbor? Surprisingly, it's usually not difficult. I have done aggregate settlements for a 4,000-claimant Polychlorinated Biphenyl case, in which all but seven claimants agreed, an 80-claimant x-ray overdose case where all claimants agreed, and three different *Chantix* aggregate settlement cases with between 90 and 300 plaintiffs each, with unanimous approval.

Aggregate settlements require a lot of contact between the claimants and the neutral doing the award allocations in order to generate understanding and trust. Often, claimants only want to be heard and to understand fully how their award was computed and how they were scored relative to other claimants. My approach has been to talk with every single claimant during the aggregate settlement process. The most difficult claimants appreciate the appeals process, in which they have an individual hearing with me and their lawyer to vet their concerns. Almost always, the claimant finally agrees that the aggregate settlement allocation is fair, and, ultimately, consents.

Another problem with aggregate settlements is resource competition between the haves and the have-nots. Almost every deal has a handful of claimants that are seriously hurt and a handful that are not hurt at all. The defendants do not want to allocate any of the settlement to the second category, but they want closure, meaning a consent and release from all claimants, major and minor. Inevitably, some of the aggregate settlement money has to be allocated to those that are not hurt. Is this unfair to those who are hurt? This is a difficult topic that plaintiffs' counsel must wrangle with in negotiating an aggregate settlement and the neutral must tackle in deciding on a fair aggregate settlement allocation. The argument for going forward is that there is power in numbers so that the serious cases get more in an aggregate deal then they would alone. This is sometimes true and sometimes not. Clearly, the have-nots have no argument against taking the deal and they usually do so. Occasionally, a have-not understands his bargaining

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position and tries to take advantage of the problem. Once this is exposed diplomatically, the claimant tends to come back to his or her senses.

III. Organizing and Managing Mass Tort Common Benefit Lawyers

A. Selecting Plaintiff Leadership

When a Federal District Court Judge is assigned an MDL, an initial organizational step is to select plaintiff leadership. Should experienced repeat players be selected by the court where dissent may be absent, or should the court have a more diverse leadership team? If a case settles, how should the fee be split between such common benefit lawyers and the lawyers with clients? In the process, is it appropriate to cut the plaintiffs lawyers' contingent fees even though the clients agreed to them in writing?

We have a square peg in a round hole problem because MDLs were created to streamline discovery and the pretrial process and then to return the cases to their home Districts for trial. *Lexecon, 523 U.S. 26 (1998)*. The Federal Judge is therefore saddled with managing an MDL for settlement on a non-class basis without Rule 23, with such aggregate settlements being presumptively private and out of his or her control.

Should there be uniform rules in selecting plaintiff leadership? Is this something the MDL Panel should draft? When I asked an unnamed MDL Panel member this question, he expressed doubt.

Professor Burch advocates a "cognitively diverse" method in appointing lead lawyers, under which they would be selected based upon interviews and merit, and would represent a broad array of clients and backgrounds. *Mass Tort Deals (Cambridge U. Press 2019)*, *Elizabeth Chamblee Burch*.

Even though there are no rules, the selection of leadership is akin to appointing class counsel, as the individual client attorneys are largely relegated to observers in many mass cases, with the lead lawyers having a fiduciary obligation to these lawyers, and their clients.

Indeed, lead plaintiff lawyers may represent all of the clients. *San Juan DuPont Plaza Fire Litigation 111 F 3rd 220 (1st Cir. 1997):* "Whether or not there is a direct of formal attorney-client relationship between plaintiffs and the Plaintiffs' Steering Committee, the PSC ... necessarily owed a fiduciary interests in the plaintiff pool, to ensure adequate representation, even though you may not have a class action. *AmChem Products, Inc., 521 U.S. 591 (1997)*."

Is it appropriate to appoint to leadership plaintiffs lawyers who have no clients? Silver and Miller say no: "A clientless lawyer will rationally want to settle on any terms a defendant will offer ... [because he or she] has no state in the MDL's upside potential, and will suffer greatly if negotiations fail." *Silver and Miller, 79 Fordham Law Review (2011), at 151*.

Should a consensus model be used to select Lead Lawyers, in which an agreed slate is presented to the court for sign-off? Doesn't this encourage undisclosed fee sharing arrangements among the lawyers or log rolling in other cases these lawyers share? This approach is probably desirable for liaison counsel, who has to get along with everyone, but it does encourage repeat players, which can stifle creativity and adequate representation.

According to Professor Burch, in the 73 product-liability and sales practices MDLs that were pending in May 2013, 750 out of 1,200 available leadership positions were occupied by lawyers who had leadership positions in more than one MDL. Fifty of the lawyers were named as lead lawyers in five or more MDLs and they have 30% of all leadership roles. One judge named the same lawyers as leads in four of the 5 MDLs he had.

Is this "mainstreaming" of the leadership the reason for certain "runaway settlements" such as in *Vioxx*, where the PSC approved a Settlement that required plaintiff lawyers

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to recommend it to all of their clients and to withdraw from representing their clients who did not settle?

To help solve the problem, Professor Burch advocates appointing new entrants to leadership positions, appointing them on an interim basis, implementing plaintiff lawyer governance rules that tolerate and promote dissent, and having special appointments to represent Plaintiffs with conflicting interests.

She suggests that the recipe for collusive settlements is repeat plaintiff leadership aggregate settlements and judges who want to settle in order to get more MDL's.

B. Mass Plaintiff Lawyer Compensation

Common benefit compensation is controversial. Judging Multidistrict Litigation, Elizabeth Chamblee Burch, 90 New York U L R 71, at 108 (2015), In re Guidant 2008 WL 682174, Vioxx, and In re Genetically Modified Rice 2010 WL 716190, the common benefit lawyers negotiating a settlement inserted fee provisions for themselves, and required individual plaintiff lawyers to waive their objections to the common benefit fees if they wanted to enroll in the settlement. Is this not unethical self-dealing because it violates the Lead Lawyers' fiduciary obligation to principals?

Here are three suggested fee solutions:

(i) Cap the tax before you leave port.

Judge Sam C. Pointer Jr., in MDL No. 926, the Breast Implant Litigation, capped the common benefit lawyers' portion of the settlement at 6% at the beginning of the case. Common benefit lawyers kept their time and expenses, which were audited by a special master, and were paid on a quantum meruit basis. When the case resolved, 2% of the 6% was given back to the plaintiffs because there was too much common benefit money.

This allowed all plaintiff lawyers to know the tax of participating in the MDL when the case began.

(ii) Enter into a lodestar agreement up front.

The common benefit and individual plaintiff lawyers can enter into an agreement on how they will propose to the court to split the fee award if the case settles, in, perhaps with the help of a special master. Though not necessarily binding, it will help make peace and encourage all lawyers to work together for the common benefit of their clients, instead of angling for fees.

(iii) Have the MDL Panel Make Fee Rules.

Though this is ambitious, it would help encourage all MDLs to have uniform and hopefully more fair fee rules and reduce judge shopping at MDL Panel case assignment hearings.

Theoretically, the Federal Judge has no legal authority to approve or disapprove an aggregate settlement. However, because fees are involved, they may be a lever that the judge could push to take a look at the fairness of an aggregate settlement.

There is no authority for capping private plaintiff contingency fee contracts in aggregate settlements, although it is done frequently. *The Quasi-Class Action Model for Limiting Attorneys' Fees in Multi-District Litigation, Jeremy Hayes, 67 NYU Annual Survey 589 (2012)*. Thus, Judge Weinsten capped *Zyprexa* fees at 35% citing public perception as the reason. Judge Donovan Frank capped them at 20% in *Guidant*, Judge Fallon capped them at 32% in *Vioxx*, and Judge Alvin K. Hellerstein reduced them from 25% to 15% in In re *September 11 Litigation 567 F. Supp. 2d 611 (SD NY 2008)*.

Intervention by the judge in the aggregate settlement compensation issue may be based on arguments of cost-savings due to economies of scale in representing large

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groups of mass case clients, or the judge's thinking that the aggregate settlement substitutes for the old class action settlement, where 25% fees are common.

IV. Role and Use of the Special Master

Rule 53 basically says that a judge, when faced with a complex or difficult matter, that will take up too much valuable time can appoint a personal aide to get help, with or without consent of the parties, in the form of a special master. Much of this work has typically been done by magistrate judges. Magistrates have been with us since 1968 and have increased in number from 470 in 1990 to 570 in 2012, although the number of cases that they have resolved skyrocketed by 227%, from 4,600 to 15,000 cases during this same period.

Special masters can be used for a variety of purposes, including negotiation and oversight of multiparty e-discovery protocols, deciding motions involving intricate facts or law, assuring ongoing compliance with sophisticated consent judgments, resolving internecine disputes between plaintiffs over fees, facilitating and mediating a settlement or administering a settlement claims process.

The Supreme Court has cautioned that judges should use special masters to aid in the performance of specific Judicial duties ... and not to displace the court. *Labuy v Howes Leather Company, 352 US 249, at 256 (1957)*. Docket congestion is not enough. *Ibid at 259*.

The suggested rule of thumb in hiring a special master is to do so when a case is so complex that it takes up too much of the court's time without obtaining help. As the parties usually split the special master costs, related factors are whether the case is already very expensive or when the parties are driving up the cost of litigation unnecessarily without the help of a special master to cool things down.

It is submitted that engaging a special master actually increases and does not reduce judicial authority, kind of like a Police Chief hiring additional cops on his or her beat. See, *Special Masters Versus Magistrate Judges, The Federal Lawyer September 2014, at 73, by David R. Cohen.*

A special master appointed early in the case can help with the selection of plaintiff leadership, resolve discovery disputes, and facilitate status conferences and cooperation between the parties. Such a special master who helps the court organize and carry out the case, is often well positioned to help the case settle. This has been my experience.

The recent 2019 ABA Guidelines on the Appointment and Use of Special Masters have been ballyhooed as a "revolution" (Merril Hirsh, ABA Fall 2019), when, indeed, they merely restate long established special master practices.

About The Author

Ed Gentle was born in Birmingham, Alabama, February 17, 1953. He graduated summa cum laude in 1975 from Auburn University where he was a Danforth Scholar and earned a Bachelor of Science degree. In 1977, he received a Master of Science (summa cum laude) from the University of Miami as a Maytag Fellow where he became familiar with the law of the sea and international resource planning issues involving competing nations.

He was a Rhodes Scholar (Auburn's second and Miami's first) at Oxford University where he earned a B.A. degree with honors in Jurisprudence in 1979. He received a M.A. degree from Oxford in 1980. He then attended the University of Alabama School Of Law as a Hugo Black Scholar. He earned his J.D. and was admitted to the Alabama State Bar in 1981.

Mr. Gentle has comprehensive experience in serving as Special Master and Claims Administrator in Mass Tort Litigation, and providing claims administration and financial and business advice to Courts, Settling Parties, and Mass Tort Settlements. He has helped create and administer over $2 Billion in Settlements during the past 20 years.

In March 2017, Mr. Gentle was elected President of the Academy of Court Appointed Masters, founded by Francis McGovern and Ken Feinberg. ¤

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Research Report

Who's Who: Patel v 7-Eleven

Franchisees' Misclassification Suit Against Convenience Store Chain

by Psyche Castillon

Dhananjay Patel, Safdar Hussain, Vatsal Chokshi, Dhaval Patel, and Niral Patel filed a putative class action lawsuit against 7-Eleven, Inc., in Massachusetts alleging that 7-Eleven misclassified its franchisees as independent contractors instead of employees.

For more than 50 years, 7-Eleven has sold convenience store franchises. In addition to its franchises, 7-Eleven operates corporate stores, which are managed and staffed by acknowledged 7-Eleven employees. As of 2018, there were approximately 1,700 company-operated 7-Elevens and 7,200 franchisee-operated 7-Elevens in the United States. About 160 of those franchisee-operated 7-Elevens are in Massachusetts.

The Plaintiffs are residents of Massachusetts who acquired 7-Eleven franchises and work as store managers and clerks in Massachusetts. The Plaintiffs also, either on behalf of himself/herself or through a third-party corporate defendant, entered into a franchise agreement for a 7-Eleven store in different locations.

The franchise agreement contains substantially similar terms. One section provides that the franchisee agrees "to hold [himself/herself] out to the public as an independent contractor" as well as to exercise "complete control" over the day-to-day operations of the store and all store employees. 7-Eleven does not pay franchisees a salary. Instead, franchisees may withdraw weekly or monthly "draws" from the store's gross profit minus the 7-Eleven Charge and store expenses. Franchisees are, however, required to ensure that their stores maintain a minimum net worth.

Both parties filed cross motions for summary judgment and the Plaintiffs filed their motion for class certification.

"ABC Test" in Massachusetts

The Plaintiffs alleged that by misclassifying them as independent contractors 7-Eleven violated Massachusetts Independent Contractor Law, Mass. Gen. L. c. 149, § 148B. As a consequence of this misclassification, 7-Eleven violated the Massachusetts Wage Act, Mass. Gen. L. c. 149, § 148 and the Massachusetts Minimum Wage Law, Mass. Gen. L. c. 151, §§ 1, 7, the Plaintiffs further alleged.

In Massachusetts, "an individual performing any service" for another is presumed to be an employee. The purported employer may rebut that presumption by establishing the following elements in the so-called "ABC Test:"

1. the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact;

2. the service is performed outside the usual course of the business of the employer; and

3. the individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

The Plaintiffs argued that (1) the Massachusetts ICL applies because they provide services that are integral to 7-Eleven's business model, (2) the Massachusetts ICL is not preempted by federal regulations, and (3) the Plaintiffs are entitled to a presumption that they are employees which 7-Eleven has failed to rebut. 7-Eleven contended the Massachusetts ICL is inapplicable because (1) it provides services to its franchisees, not the other way around, and (2) compliance with another state law makes it impossible for 7-Eleven to satisfy the first element of the Massachusetts ICL.

The threshold inquiry under the Massachusetts ICL

Research Report

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is whether an individual provides "any services" to the purported employer. "Services" is construed liberally to effectuate the remedial purpose of the statute in "protect[ing] employees from being deprived of the benefits enjoyed by employees through their misclassification." Whether a worker provides services to a purported employer is, ordinarily, a question of fact on which the plaintiff bears the burden of proof.

Element of control

7-Eleven contended that, because federal regulation makes it impossible to satisfy the first prong of the ABC Test, the test does not apply. Prong 1 requires 7-Eleven to demonstrate that the Plaintiffs are "free from control and direction in connection with the performance of the service." The inquiry is primarily concerned with the actual relationship of the parties, although contractual provisions governing the relationship are instructive. To meet its burden under Prong 1, a purported employer must demonstrate that the worker is free from supervision "as to the result to be accomplished" and as to the "means and methods…utilized in the performance of the work."

The Plaintiffs offered a litany of examples of the control 7-Eleven exercises over them both in reality and as provided for in the Franchise Agreement. For example, they submitted 7-Eleven corporate market managers communicate with franchisees daily and inspect their stores. 7-Eleven responded with counter-examples of the control franchisees exercise over their stores. For instance, 7-Eleven pointed out that under Section 2 of the Franchise Agreement, the Plaintiffs exercise "complete control" over the operation of the store and all store employees. 7-Eleven nevertheless conceded that it does exercise some level of control over its franchisees but argued it is bound to do so by a federal regulation called the Federal Trade Commission Franchise Rule.

The FTC Franchise Rule defines a franchise as:

any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

1. The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;

2. The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

3. As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

The FTC amended the rules in 2008, which amendment provided that a business relationship "will not be covered [by the FTC Franchise Rule] unless it meets the three definitional elements [of a franchise]."

According to Judge Nathaniel M. Gorton of the U.S. District Court for the District of Massachusetts, the bolded language is in direct conflict with Prong 1 of the Massachusetts ICL. Where the FTC Franchise Rule defines a franchisor as one who exerts a "significant degree of control over the franchisee's method of operation," the Massachusetts ICL requires an individual to be classified as an employee unless that individual is "free from control and direction in connection with the performance of the service."

The Massachusetts Supreme Judicial Court ("the SJC") addressed a similar tension in *Monell v. Boston Pads, LLC,*

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31 N.E.3d 60 (Mass. 2015). In *Monell*, the SJC considered whether a Massachusetts real estate statute could be squared with the Massachusetts ICL. The real estate statute required brokers to maintain a certain level of control and supervision over sales agents. The mandated level of supervision and control over agents made it "impossible" for brokers to satisfy Prong 1 of the Massachusetts ICL. The SJC concluded that, although there was no exception in the Massachusetts ICL for real estate brokers, the inherent conflict rendered the Massachusetts ICL inapplicable.

Monell suggests that where a relationship as defined by regulation expressly precludes the satisfaction of a prong of the independent contractor statute, the independent contractor statute will not govern. 7-Eleven contended the FTC Franchise Rule requires a degree of control that runs afoul of the Massachusetts ICL.

The Plaintiffs' first retort is that "courts in Massachusetts and around the country have routinely applied [the ABC Test] to franchisors." The Defendant noted, however, that each of the cases relied upon by the Plaintiffs either predates *Monell* or applies foreign law not subject to *Monell*. The Plaintiffs' second rebuttal is that 7-Eleven's failure to address the second and third prongs of the conjunctive ABC Test is fatal. Their argument misapplies *Monell* which stands for the proposition that the Massachusetts ICL is inapplicable if a competing statutory scheme precludes satisfaction of any one prong.

The Plaintiffs next contended that 7-Eleven's argument rests on a flawed interpretation of Prong 1 as requiring an individual to be entirely free from control to qualify as an independent contractor. The Plaintiffs are correct that the "control" prong is not to be interpreted so narrowly as to forbid any level of control but allows for some direction and control. The FTC Franchise Rule, however, requires more than just "some" control. It requires a franchisor to exercise "significant" control or else risk not complying with the FTC Franchise Rule. In doing so, the rule established a regulated classification status unique from that of an employee or independent contractor.

The Guide describes the kinds of business arrangements and relationships governed by the FTC Rule, by defining the level of control or assistance a worker must be provided. To be deemed "significant" the control or assistance offered by the franchisor must "relate to the franchisee's overall method of operation." Significant control includes:

- site approval for unestablished businesses;
- site design or appearance requirements;
- hours of operation;
- production techniques;
- accounting practices;
- personnel policies;
- promotional campaigns requiring franchisee participation or financial contribution;
- restrictions on customers; and
- locale or area of operation.

Significant forms of assistance include:

- formal sales, repair, or business training programs;
- establishing accounting systems;
- furnishing management, marketing, or personnel advice;
- selecting site locations;
- furnishing systemwide networks and website; and
- furnishing a detailed operating manual.

The FTC Franchise Rule also provides that to qualify as a franchise, a franchisee must obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated

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with the franchisor's trademark. Federal trademark law, in turn, mandates that a trademark licensee must maintain control over the use of its trademark or risk constructive abandonment.

Revealing the inherent conflict between the FTC Franchise Rule and the Massachusetts ICL, the list of control and assistance identifiers in the Guide is nearly identical to the litany of control measures that the Plaintiffs proffered in support of their misclassification argument. Although the FTC Franchise Rule does not compel an individual to exercise the control measures listed in the Guide or grant a license to utilize its trademark, it defines the relationship resulting from those measures as a franchise.

It cannot be the case, as the Plaintiffs suggested, that, in qualifying as a franchisee under the FTC's definition, an individual necessarily becomes an employee. In effect, such a ruling by this Court would eviscerate the franchise business model, rendering those who are regulated by the FTC Franchise Rule criminally liable for failing to classify their franchisees as employees. Not only is such a conclusion unsupported by Massachusetts law but it also implicates a legislative decision beyond the purview of the Court, Judge Gorton pointed out.

Where there is a conflict between the Massachusetts ICL and a regulatory scheme, the specific trumps the general. The franchise-specific regulatory regime of the FTC governs over the general independent contractor test in Massachusetts. Accordingly, Judge Gorton held that the Massachusetts ICL does not apply to 7-Eleven in these circumstances.

The SJC recognized in *Monell* that its holding was limited insofar as it determined that the plaintiffs could not recover under the Massachusetts ICL but took no position as to whether they were, in fact, employees according to some other unidentified common law or statutory test. The SJC acknowledged as much because the real estate statute, although in conflict with the Massachusetts ICL, nonetheless contemplates a real estate salesperson as being "either…an employee or…an independent contractor" of a broker.

The FTC Franchise Rule does not contain such explicit language. It does, however, leave open the possibility that a franchisee may be subject to several classifications. The Court need not resolve such ambiguity on these facts, however, because the plaintiffs seek employee classification based only on the Massachusetts ICL. Despite the suggestive language in both *Monell* and the FTC Franchise Rule, the Plaintiffs proffered no alternative test for classification status or even suggest an alternative exists. Consequently, summary judgment in favor of the defendant is appropriate on all counts, Judge Gorton concluded.

Having so concluded, Judge Gorton denied the plaintiffs' motions for summary judgment on 7-Eleven's liability for misclassification and class certification. Judge Gorton also ruled that 7-Eleven's counterclaims and third-party claims for (1) declaratory judgment that the various franchise agreements are void; (2) breach of contract; and (3) contractual indemnity are not the subject of any summary judgment motion and, therefore, remain pending.

Judge Gorton allowed 7-Eleven's motion for summary judgment and denied the motions of plaintiffs for summary judgment and class certification.

What's next?

The trial court set a November 30, 2020 deadline for all remaining discovery. Jury trial was scheduled to commence in January 2021. In a notice dated Dcember 7, 2020, the court cancelled the final pretrial conference

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originally scheduled for December 10 as well as the jury trial set for January 4.

Meanwhile, the Plaintiffs have taken an appeal from the trial court's order denying their class certification request and allowing 7-Eleven's motion for summary judgment. On appeal, the Plaintiffs ask the U.S. Court of Appeals for the First Circuit to consider whether the Massachusetts Wage Act test for independent contractor misclassification applies to workers who are clasified as franchisees, or whether instead this test is preempted by federal franchise regulations that govern pre-franchise disclosures. Appellate briefing is underway.

Patel is not the only misclassification case filed by franchisees against 7-Eleven. In 2018, the U.S. District Court for the Central District of California also granted 7-Eleven's motion for judgment on the pleadings and dismissed the plaintiffs' lawsuit with prejudice in *Haitayan, et al. v. 7-Eleven, Inc.,* Case No. CV 17-7454-JFW, 2018 WL 1626248 (C.D. Cal. Mar. 14, 2018).

While the *Haitayan* court stated that "no binding decision ha[d] addressed which standard courts should apply in determining whether a franchisor is an employer of a franchisee," the *Haitayan* court's analysis shows that it appreciated the unique nature of the franchised business model and the need to recognize the features of that model in assessing the viability of the franchisees' claims, according to Elior Shiloh, partner, and Andrew Williamson, associate, at Lewis Brisbois.

The Lewis Brisbois lawyers pointed out the *Patel* and *Haitayan* cases state that franchisors, under statutes and practice, are required to exert a certain degree of control over their franchisees' operations, but this control cannot be enough to transform a franchisor into either an employer or a joint employer. They further pointed out that California courts are also strong defenders of the franchised business model as at least five different federal courts have concluded that an employment relationship did not exist between a franchisor and its franchisees or its franchisees' employees. See *Roman v. Jan-Pro Franchising Int'l, Inc.,* No. C 16-05961 WHA, 2017 WL 2265447 (N.D. Cal. May 24, 2017); *Salazar v. McDonald's Corp.,* No. 14-02096, 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016); *Vann v. Massage Envy Franchising LLC,* No. 13-CV-2221-BEN (WVG), 2015 WL 74139 (S.D. Cal. Jan. 5, 2015); *Ochoa v. McDonald's Corp.,* 133 F. Supp. 3d 1228 (N.D. Cal. 2015); *Ambrose v. Avis Rent A Car Sys., Inc.,* No. 2:11-cv-09992-CAS (AGRx), 2014 WL 6976114 (C.D. Cal. Dec. 8, 2014). While some of these rulings are on appeal, California's body of law on these issues is currently one of the most settled in the country, the Lewis Brisbois lawyers noted.

DEFENDANT'S LAWYERS

Norman M. Leon, **Jennifer Brown**, **Miles D. Norton**, **Matthew J. Iverson** of **DLA Piper LLP (US)**, represent 7-ELEVEN, INC., Mary Carrigan, and Andrew Brothers.

PLAINTIFFS' LAWYERS

Shannon E. Liss-Riordan and **Adelaide H. Pagano** of **Lichten & Liss-Riordan, PC**, represent Vatsal Chokshi, Safdar Hussain, Dhananjay Patel, Dhaval Patel, Niral Patel.

The district court case is *Patel et al. v. 7-ELEVEN, INC., et al.,* 1:17-11414 (D. Mass.), and assigned to **Hon. Nathaniel M. Gorton.**

The appellate case is *Patel, et al v. 7-ELEVEN, INC.*, Case No. 0:20-01999 (1st Cir.). ¤

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Who's Who: Turek Enterprises v State Farm Mutual
Are Insurers Liable to Property Owners for COVID-19-Related Losses?

by Psyche Castillon

On June 23, 2020, Turek Enterprises, Inc., d/b/a Alcona Chiropractic, filed a complaint against State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Company, on behalf of itself and all others similarly situated, alleging that State Farm failed to compensate Turek's loss of income and extra expense as required by an insurance contract between the parties.

On May 22, 2019, Turek entered into a one-year term, "all-risk" insurance contract with State Farm Casualty. The Policy covers loss of income and extra expense (commonly referred to as "business interruption losses") and includes a lengthy list of exclusions, including a subsection governing fungi, viruses, and bacteria referred to as the "Virus Exclusion." Insurers began to add the Virus Exclusion and similar terms to contracts in 2006, after the severe acute respiratory syndrome ("SARS") outbreak. The Virus Exclusion bars coverage for any loss that would not have occurred but for some "[v]irus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness, or disease."

Business Losses Due to COVID-19

The first recorded case of the 2019 novel coronavirus ("COVID-19") in Michigan was reported on March 10, 2020. The next day, the World Health Organization declared COVID-19 a pandemic. On March 24, the Governor of the State of Michigan issued Executive Order 2020-21, which suspended activities that "are not necessary to sustain or protect life." Under the Executive Order, no person or entity shall operate a business or conduct operations that require workers to leave their homes or places of residence except to the extent that those workers are necessary to sustain or protect life or to conduct minimum basic operations.

On March 24, 2020, Turek suspended all business operations in compliance with the Executive Order. As a result, Turek lost the use of its Covered Property until at least May 28. On May 22, Turek renewed the Policy with State Farm Casualty for a new term expiring on May 22, 2021. On June 4, 2020, Turek made a claim with State Farm Casualty for loss of income and extra expense as a result of the Order, but State Farm Casualty denied this claim stating that "the insured property has not sustained accidental direct physical loss. There are exclusions for virus [sic], enforcement of ordinance or law, and consequential losses. ..."

On June 23, 2020, Turek filed this complaint against State Farm. Turek contended its losses fall within the Loss of Income, Extra Expense, and Civil Authority sections of the Endorsement. With respect to the Virus Exclusion, Turek maintained the Order was the sole cause of its losses. The Order, according to Turek, was issued "to ensure the absence of the virus, or persons carrying the virus, from the Plaintiff's premises," and "there is no evidence at all that the virus did enter Plaintiff's property or that it had to be de-contaminated."

Turek alleged State Farm has issued "hundreds or thousands" of identical or substantially similar policies to businesses across Michigan. Turek further alleged these businesses, like the Plaintiff, have suffered losses from the Order that the Defendants have wrongly refused to cover. Accordingly, Turek sought damages for its losses and a declaratory judgment that the Policy covers the loss of income and extra expense sustained. Turek sought the relief on behalf of itself and three proposed classes that correspond to types of Endorsement coverage.

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Business Interruption Losses

State Farm's principal argument is that Turek's business interruption losses were not caused by a Covered Cause of Loss. Specifically, State Farm argues that (1) the Plaintiff's losses are not the result of an "accidental direct physical loss to Covered Property," and (2) even if they were, they are excluded by the Virus Exclusion or some other exclusion, such as the Ordinance or Law, Acts or Decisions, or Consequential Losses exclusions.

The threshold question in the complaint is whether Turek suffered an "accidental direct physical loss to Covered Property." The Policy does not define the term "direct physical loss," and the parties offer different interpretations. State Farm contended contend that the term requires "tangible damage" to Covered Property, like the damage one could expect from a fire. The Plaintiff offered the broader interpretation that "direct physical loss" includes "loss of use."

Under this view, any event rendering Covered Property "unusable or uninhabitable" would trigger coverage, regardless of whether any tangible damage to the property resulted. Importantly, Turek was adamant that COVID-19 never entered its premises. According to Turek, its loss of income and extra expense arise only from its suspension of operations in compliance with the Order. As a result, Turek's entire case turns on the construction of "direct physical loss."

While Michigan courts have not interpreted the term "direct physical loss," the Sixth Circuit Court of Appeals interpreted a similar term in *Universal Image Prods., Inc. v. Fed. Ins. Co.,* 475 F. App'x 569, 572 (6th Cir. 2012). In Universal, the district court found that "direct physical loss or damage" required "tangible damage" and entered summary judgment for the defendants. The Sixth Circuit affirmed, noting that "[the plaintiff] did not experience any form of 'tangible damage' to its insured property" and that its losses were not "physical losses, but economic losses." In so holding, the Sixth Circuit found *de Laurentis v. United Servs. Auto. Ass'n,* 162 S.W.3d 714 (Tex. App. 2005), to be persuasive. In *de Laurentis*, the Texas Court of Appeals held that "physical loss" required "tangible damage" after analyzing the dictionary definitions of "physical" and "loss." *De Laurentis* "provid[ed] insight into how the Michigan courts would interpret the phrase 'direct physical loss'" because the Michigan Court of Appeals had previously relied on *de Laurentis* to interpret the word "direct."

State Farm offered the only interpretation resembling the "plain and ordinary meaning" of "direct physical loss." Michigan courts determine a word's ordinary meaning by consulting a dictionary. Merriam-Webster Dictionary defines "physical" as "having material existence; perceptible especially through the senses and subject to the laws of nature." Here, "physical" is an adjective modifying "loss," which is defined as, inter alia, "destruction, ruin," "the act of losing possession," and "a person or thing or an amount that is lost."

Turek suggested "physical loss to Covered Property" includes the inability to use Covered Property. Judge Thomas L. Ludington of the U.S. District Court for the Eastern District of Michigan said this interpretation seems consistent with one definition of "loss" but ultimately renders the word "to" meaningless. "To" is used here as a preposition indicating contact between two nouns, "direct physical loss" and "Covered Property."

Accordingly, the plain meaning of "direct physical loss to Covered Property" requires that there be a loss to Covered Property; and not just any loss, a direct physical

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loss. Turek's interpretation would be plausible if, instead, the term at issue were "accidental direct physical loss of Covered Property," Judge Ludington said.

State Farm's interpretation is also consistent with recent COVID-19-related cases interpreting similar or identical terms. In *Diesel Barbershop, LLC v. State Farm Lloyds,* No. 5:20-CV-461-DAE, 2020 WL 4724305 (W.D. Tex. Aug. 13, 2020), the court addressed facts nearly identical to this case. The *Diesel* plaintiffs sought damages from a State Farm insurer that refused to compensate business interruption losses incurred by COVID-19-related "shutdown" orders. The *Diesel* plaintiffs suffered no tangible damage to property but alleged that loss of use was sufficient. The insurance policy included the same material terms at issue in the Turek case. While the *Diesel* court noted "that some courts [had] found physical loss even without tangible destruction," "the line of cases requiring tangible injury to property [was] more persuasive." Accordingly, the court dismissed *Diesel*, holding that the plaintiff failed to state an "accidental direct physical loss to Covered Property."

Similarly, the Ingham County Circuit Court recently adopted the tangible damage interpretation to dismiss a COVID-19-related insurance case in *Gavrilides Management Co. LLC v. Michigan Insurance Co.,* Case No. 20-258-CB-C30 (Mich. Cir. Ct., Ingham Cty.). The *Gavrilides* plaintiff claimed it suffered "direct physical loss" to its restaurant because the Order prevented customers from dining-in. The *Gavrilides* court dismissed the argument as "simply nonsense" and agreed with the insurer-defendant that the phrase "accidental direct loss of or damage to property" required "some physical alteration to or physical damage or tangible damage to the integrity of the building."

Judge Ludington found that Turek's reliance on *Studio 417, Inc. v. Cincinnati Insurance Co.,* No. 20-cv-03127-SRB (W.D. Mo. Aug. 12, 2020), is unpersuasive. In that case, the plaintiffs alleged business interruption losses from COVID-19-related "shutdown" orders that their insurer refused to compensate. The defendant moved to dismiss, but the *Studio* court denied the motion, finding that the plaintiffs had plausibly stated losses within coverage. Despite apparent similarities, Studio is readily distinguishable from the *Turek* case, Judge Ludington pointed out. The policy at issue in *Studio* covered losses arising from "accidental physical loss or accidental physical damage to property." According to the *Studio* court, the defendant's insistence on a showing of tangible damage "conflat[ed] 'loss' and 'damage'" and was inconsistent with "giv[ing] meaning to both terms." Furthermore, the Studio plaintiffs "plausibly alleged that COVID-19 particles attached to and damaged their property," a fact which the court used to distinguish *Source Food Tech., Inc. v. U.S. Fid. & Guar. Co.,* 465 F.3d 834, 838 (8th Cir. 2006). By contrast, Turek asserted that COVID-19 never entered its premises, and State Farm's interpretation would not read "direct physical loss" redundantly. Even if *Studio* supports Turek's interpretation, its analysis is inapplicable, Judge Ludington held.

Turek also argued it has stated "tangible damage" because it "alleged tangible deterioration during the several months that [its] operation has been 'suspended.'" In support, Turek pointed to paragraph 35 of the complaint, which states, "Among the property so damaged is Plaintiff's chiropractic equipment, certain leased equipment, medication and supplements with expiration dates, and other depreciating assets."

Judge Ludington found that Turek is simply adding

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an extra step to its original theory. Rather than the loss of use being the "direct physical loss," the "direct physical loss" is now the passive depreciation caused by the loss of use. Judge Ludington ruled that Turek offered no authority to support the theory that passive depreciation counts as a "direct physical loss to Covered Property," and such a conclusory allegation fails to "state a claim to relief that is plausible on its face."

Based on this, "accidental direct physical loss to Covered Property" is an unambiguous term that requires Turek to demonstrate some tangible damage to Covered Property. Because Turek has failed to state such damage, the complaint does not allege a Covered Cause of Loss.

What's Next

Judge Ludington granted State Farm's motion to dismiss and dismissed Turek's complaint with prejudice. No appeal was taken.

Arthur H. Aufses III, commercial litigator and a partner Kramer Levin Naftalis & Frankel LLP, and associates Andrea Maddox and Susan Jacquemot, pointed out that some states have proposed legislation that would force insurers to cover COVID-19-related claims despite any contrary provisions in their policies, but the proposed legislations were met with oppositions from the insurance industry, with insurers saying the bills impairs contracts.

Aufses et al. also pointed out that more than a thousand COVID-19-related insurance coverage lawsuits have been filed across the country in state and federal courts. In August, after hearing oral arguments, the federal Judicial Panel on Multidistrict Litigation decided not to consolidate the cases, finding that they "share only a superficial commonality" and no common defendant, and that the cases could not be consolidated efficiently.

Aufses et al. said whether other plaintiffs will follow suit, and whether this approach gains any traction with the courts, remains to be seen and pointed out that the outcome is likely to depend on, among other things:

i. whether physical alterations that are not themselves caused by the virus, but rather are made voluntarily by an insured in order to facilitate continued operations, are held to constitute "direct" physical damage, and

ii. whether the nature and extent of the alterations are sufficient to constitute physical damage or loss.

DEFENDANT'S LAWYERS

Matthew P. Allen, Paul D. Hudson, and **Thomas W. Cranmer** of **Miller, Canfield, Paddock and Stone, PLC**, represent State Farm Fire and Casualty Company and State Farm Mutual Automobile Insurance Company.

PLAINTIFFS' LAWYERS

Kenneth F. Neuman, Jennifer M. Grieco, and **Stephen T. McKenney** of **Altior Law, PC**, and **Jason J. Thompson of Sommers Schwartz, PC**, represent Turek Enterprises, Inc., d/b/a Alcona Chiropractic.

The case is *Turek Enterprises, Inc., d/b/a Alcona Chiropractic v. State Farm Mutual Automobile Insurance Company, et al.*, Case No. 1:20-cv-11655 (E.D. Mich.).

The case is assigned to **Hon. Thomas L. Ludington** ¤

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