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WARN Act

Keeping Employees in the Dark about a Looming Bankruptcy: Know the Risks

Warn Act

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However, management needs to be equally concerned that shielding employees from the true state of the business may expose the company, or perhaps worse yet, management individually, to claims by the employees. In this Bloomberg Law Insights article, *Mark Horoupian of SulmeyerKupetz PC* discusses management's obligations to its employees and the implication of bankruptcy on those obligations.

BY MARK HOROUPIAN

Although corporate bankruptcies may not be as ubiquitous as they were in the wake of the Great Recession, Chapter 11 remains a haven for troubled companies. Pulling the trigger on putting a company into bankruptcy is typically a very stressful ordeal for management, and is commonly looked at as the stop of last resort. Entrepreneurs are optimistic by nature, and the optimism that a white knight is just around the corner often has business owners put off the decision to file until it cannot be put off any longer. During the boardroom deliberations, management rarely lets rank-and-file employees know about the possibility of bankruptcy until the last minute, and many times not until after the petition is actually filed.

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The tendency to want to keep the employees "in the dark" is understandable from the perspective of management. The news of financial distress of the employer is not the best thing for employee morale. To many, bankruptcy necessarily means the end of their jobs. That a company may be restructured or sold in tact through a bankruptcy, thus preserving jobs, is a fact that is not appreciated or understood by all. Management is rightfully concerned that telling employees before they absolutely have to is bad for productivity, and may also lead to a mass migration of its workforce. (However, it is the author's experience that the latter

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rarely happens. Jobs are not easy to come by, and although skilled workers who are ''marketable'' may leave, the majority of the workforce seems to remain with the company as long as they are being paid.)

Management needs to be equally concerned, however, that shielding employees from the true state of the business may expose the company, or perhaps worse yet, management individually, to claims by the employees. It is critical that any distressed company discuss with its lawyers, as early in the process as possible, its obligations to its employees and the implication of bankruptcy on those obligations.

As bankruptcy is considered, employers should pay close attention to their obligations under the Worker Adjustment and Retraining Notification Act (Federal ''WARN Act'' or the ''Act''), 29 U.S.C. § § 2101-2109, which requires covered employers to give 60 days' advance written notice to affected employees in the case of either a permanent or extended temporary plant closing or mass layoff. In addition, many states have their own version of WARN, and just because an employer may not be required to give notice to its employees under the Federal WARN Act does not necessarily mean that the employer is exempt under the state statute. For example, under California's WARN Act, California Labor Code Section 1400-1408 ("Cal-WARN"), a business with 75 or more employees without distinction between full- and part-time, would need to give the required notice, whereas under the Federal WARN Act, the threshold is either 100 or more employees, excluding part-time. Accordingly, a business with 85 employees would not need to give notice under the Federal WARN Act, but would be required to do so under the California version of the statute. While the Federal and State WARN statutes generally track each other, there are significant differences that employers need to be aware of during insolvency planning, particularly where closures and/or mass layoffs are a possibility. For a comprehensive comparison of the Federal WARN Act to Cal-WARN, see http://www.edd.ca.gov/jobs_and_training/Layoff_Services_WARN.htm.

There are certain delineated exceptions to the Federal WARN Act that may excuse the obligation to give notice. One of those exceptions that most frequently comes into the conversation when discussing bankruptcy is the ''faltering company'' exception. That exception excuses the notice requirement where the employer was actively seeking capital or business at the time notice would have been required, that was realistically obtainable and, if obtained, would have allowed the employer to avoid or postpone the shutdown. The employer must demonstrate that it reasonably and in good faith believed that giving the required notice would have prevented it from getting the financing or business. This exception only applies for plant closures not mass layoffs. In other words, an entire plant or business needs to have been shut down for the exception to apply. California has a correlating exception codified at Labor Code Section 1402.5. Like the Federal exception, the California faltering business exception only applies to plant closures not mass layoffs. In addition, to be protected by this exception, the company must convince the California Department of Industrial Relations ("DIR") that it falls within the exception. Interestingly, the DIR and courts interpreting the Federal WARN Act have taken the position that a failing company that is seeking to sell itself is not ''seeking capital or new business'' and, therefore, fails to qualify for the faltering business exception. This should be particularly troubling to employers headed toward bankruptcy because one of the most common exit strategies explored as an alternative to filing bankruptcy is a sale.

The failure to give a required notice under the WARN Act exposes the company to damages equal to the employees' wages and benefits for each day that the required notice was not given. For example, if the required notice was given only 15 days before a mass layoff, the employees would be entitled to 45 days of back pay and benefits. In addition, a court may award the employees their reasonable attorneys' fees. As such, management's decision to shield the employees from impending bad news could expose the company to very significant penalties. Claims for violations of the WARN Act terminated prior to the filing of a case may be entitled to priority over other unsecured claims pursuant to Bankruptcy Code § 507(a)(4). Furthermore, the mere size of the claims could significantly affect the outcome of the company's bankruptcy. In a case that was recently argued before the United States Supreme Court, *Czyzewski v. Jevic Holding Corporation*, No. 15-649, WARN violations were front and center in the case. Though the main issue in the case is not the underlying liability for the violations, but the permissibility of settlements that violate the Bankruptcy Code's order of creditor priority, the case highlights the fact that failure to give the WARN notice could transform a typically quiet constituency of employees into a formidable group with a large claim to be dealt with in the bankruptcy case. In *Jevic*, 1,785 employees were laid off suddenly. They sued their bankrupt employer for violation of the WARN Act, and obtained summary judgment. Their claims have been valued at more than $12 million, and it is this creditor body that is trying to stand in the way of a deal between the company, its lenders, and its general unsecured creditors.

Perhaps more troubling for management should be the specter of personal liability for violations of the WARN Act. Under the Fair Labor Standards Act ("FLSA") (29 U.S.C. § 201) it has been established law that those in economic control of a company are considered employers and thus potentially liable for violations of wage and hour regulations, such as failure to pay minimum wages. Despite its broad imposition of personal liability on officers and directors, the FLSA definition of employer has <u>not</u> been extended to WARN Act violations, and therefore, directors, officers, and managers have generally enjoyed protection against such actions unless grounds exist to pierce the corporate veil. In California, the recently enacted Fair Day's Pay Act amended the California Labor Code and adds section 588.1, which expressly defines employer to include a ''natural person who is an owner, director, officer, or managing agent of the employer.'' As a result, employees can directly sue corporate owners, directors, officers, or managers who violate, or cause to be violated, various wage and hour laws in the Labor Code. Violations of Cal-WARN, however, <u>are not</u> covered by the Fair Day's Pay Act. The California Supreme Court has not directly ruled whether or not the ''expansive'' definition of employer applies in the context of violations of Cal-WARN. Caution should be taken, however, that the definition of employer for purposes of Cal-WARN includes any person who ''directly or indirectly owns and

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operates a covered establishment.'' It is conceivable then, that a sole shareholder of a company may be held personally liable under this theory. Based upon this analysis, California labor and employment lawyers generally advise their clients that (a) they are not personally liable for Federal WARN violations and, (b) while it's an open question, they should not be liable for Cal-WARN violations.

While seemingly protected from personal liability under WARN, directors and officers should be particularly concerned about a fairly recent decision out of the Delaware Bankruptcy Court, which held that directors and officers could be sued individually for breaching their fiduciary duty to the bankrupt company by failing to give the required notice, thereby subjecting the company to additional claims. In *Stanziale v. MILK072011, LLC (In re Golden Guernsey Dairy, LLC)*, 548 B.R. 410 (Bankr. D. Del. 2015), in denying the individual defendant's motion to dismiss the case, the bankruptcy court noted that the managers and officers ''maintained the Debtor's operations until the last moment, thereby exposing Debtor to the WARN Act claims.'' While the underlying case has yet to be decided, the fact that the cause of action survived bankruptcy and has been noted by trustees and bankruptcy practitioners throughout the United States as a novel potential avenue for recovery for creditors, and by employment lawyers as a new cause for concern.

While insulating employees from the financial woes of a company may seem prudent to the management of a company in crisis, the risks associated with this approach should not be ignored. Even if management is able to delay the ultimate decision to file bankruptcy and/or cease operations, they should not put off discussing their obligations viz a viz the company's employees with competent advisors who can assist them in minimizing the exposure to the company and managers alike.