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Commentary

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WARN Act Decision: How Private Equity Might Avoid "Single Employer" Status

Delaware Bankruptcy Court Holds that Private Equity Firm And Its Portfolio Company Are Not Liable Under Federal WARN Act

The United States Bankruptcy Court for the District of Delaware recently ruled that a private equity firm was not liable under the Worker Adjustment and Retraining Notification Act (WARN Act) with respect to employee layoffs in connection with the closure of one of its portfolio company's operations.[1] This decision, which was issued by a highly influential bankruptcy court where numerous major chapter 11 cases are filed, provides valuable guidance for private equity firms and lenders to distressed portfolio companies.

In a separate decision in the same case, the Bankruptcy Court held that the bankrupt portfolio company itself was not liable under the federal WARN Act because it qualified for the Unforeseeable Business Circumstances exception to federal WARN Act liability.[2] This decision provides guidance germane to private equity firms and lenders as to when certain exceptions to liability might apply to the extent a plaintiff can adequately plead that such private equity firms and lenders may be liable under the "single employer" theory described in this alert.

Background

In 2006, a wholly-owned subsidiary of Sun Capital Partners, Inc. (Sun) acquired Jevic Transportation, Inc. (Jevic) in a leveraged buyout. In connection with the transaction, Jevic obtained an $85 million revolving credit facility. During 2007, Jevic's business struggled because of the global economic downturn and the negative impact of fuel surcharges on its transportation business. By the end of that year, Jevic defaulted under its revolving credit facility. The lead bank under the revolving credit facility agreed to multiple forbearance agreements between January 2008 and April 2008. Jevic also retained an investment bank and began an active sale process.

By the end of April 2008, however, Jevic again defaulted under its revolving credit facility. Moreover, the sale process did not yield a viable transaction, and Sun declined to invest any additional funds in Jevic. When the lenders declined to extend the forbearance period further, Jevic's only option was a bankruptcy filing.

Jevic sent its employees termination notices pursuant to the WARN Act on May 19, 2008 and filed its bankruptcy petition in the US Bankruptcy Court for the District of Delaware the next day. Jevic's employees were terminated before the end of the required 60-day period under the WARN Act. Thereafter, a class of plaintiffs commenced adversary proceedings against both Sun and Jevic in the Bankruptcy Court, alleging violations of the WARN Act.

The WARN Act

The WARN Act provides, in part, that "[a]n employer shall not order a plant closing or mass layoff until the end of a 60-day period after the employer serves written notice of such an order –

- to each representative of the affected employees as of the time of the notice or, if there is no such representative at that time, to each affected employee; and
- to the State or entity designated by the State to carry out rapid response activities under section 134(a)(2)(A) of the Workforce Investment Act of 1998, and the chief elected official of the unit of local government within which such closing or layoff is to occur."[3]

The WARN Act provides certain exceptions to the 60-day notice requirement, including the Unforeseeable Business Circumstances exception and the Faltering Company exception.

The Litigation Against Sun

The plaintiffs alleged that Sun and Jevic were a "single employer," and that Sun accordingly was liable for any WARN Act violations that Jevic may have committed. The plaintiffs' reasons for seeking to bring claims against Sun is understandable — potential recoveries from bankrupt Jevic would be meager compared to potential recoveries from Sun if the plaintiffs could prevail on their "single employer" claim. Sun responded that it could not be held liable under the WARN Act because it and Jevic were not a single employer. Both parties filed summary judgment motions. The Bankruptcy Court granted Sun's motion and denied the plaintiffs' motion.

- The Bankruptcy Court's Application of the "Single Employer" Test

The United States Department of Labor's (DOL) regulations provide that the question of whether a parent and its subsidiary constitute a "single employer" depends on the degree of the subsidiary's independence from the parent. Those regulations state that the following non-exclusive list of factors should be considered in determining whether a parent and its subsidiary constitute a single employer: (a) common ownership, (b) common directors or officers, (c) de facto exercise of control, (d) unity of personnel policies emanating from a common source, and (e) dependency of operations.[4] The Third Circuit adopted these factors in *Pearson v. Component Tech. Corp*.[5]

In its decision, the Bankruptcy Court held that common ownership existed between Sun and Jevic, noting that Sun indirectly owned 100 percent of Jevic's equity. Accordingly, the Court held that the first factor (common ownership) weighed in favor of the plaintiffs' single employer claim.

With respect to the second factor (common directors or officers), the Bankruptcy Court held that Sun and Jevic had common directors or officers, because two members of Jevic Holding Corp.'s board held officer positions at Sun's direct subsidiary (which was the direct parent of Jevic Holding Corp.)[6] Thus, the Bankruptcy Court held that the second factor weighed in favor of the plaintiffs' single employer claim. However, the Bankruptcy Court noted that under Third Circuit precedent, the first and second factors alone are insufficient to establish that a parent and its subsidiary constitute a single employer.[7]

With respect to the third factor (de facto exercise of control), the Bankruptcy Court stated that it had to consider "whether the parent has specifically directed the allegedly illegal employment practice that forms the basis for the litigation,"[8] but that a parent's exercise of control pursuant to the ordinary incidents of stock ownership does not weigh in favor of the parent's liability.[9] The Bankruptcy Court held that although Sun had some oversight of Jevic (for example, two Sun officers were on the board of Jevic Holding Corp.), that oversight did not rise to the level of de facto control because Sun personnel were not involved in the day-to-day operations of Jevic. Most importantly, Sun personnel were not involved in the hiring and firing of employees, and they were not involved in Jevic's ultimate decision to close its facilities.[10] The Bankruptcy Court also rejected the plaintiffs' contention that Sun's decision to stop funding Jevic was tantamount to exercise of control, concluding that Jevic made the ultimate decision (after consulting with outside advisors that it retained on its own) to terminate its operations.

With respect to the fourth factor (unity of personnel policies emanating from a common source), the Bankruptcy Court stated that it had to consider whether Sun and Jevic actually functioned as a single entity with regard to its relationships with employees.[11] The court's consideration included an analysis of whether Sun and Jevic engaged in centralized hiring and firing, payment of wages, and personnel and benefits recordkeeping.[12] The Bankruptcy Court concluded that Sun and Jevic did not function as a single entity in this regard, noting that the only evidence the plaintiffs introduced on that issue were (i) a one-day Sun training conference that Jevic's CFO attended, (ii) that Jevic's CEO received a "best practices" toolkit from Sun, which the CEO was not even obligated to use, and (iii) allegations (which the Bankruptcy Court stated were not supported by the evidentiary record) that Jevic joined Sun's healthcare initiative and that Jevic shared certain incentive programs with Sun. The Bankruptcy Court held that the plaintiffs' evidence was not sufficient to establish unity of personnel policies between Sun and Jevic.

With respect to the fifth factor (dependency of operations), the Bankruptcy Court considered the existence of arrangements such as the sharing of administrative services, interchanges of employees or equipment and commingled finances.[13] The court noted, however, that dependency of operations cannot be established by a parent corporation's exercise of its ordinary powers of subsidiary ownership. The Bankruptcy Court held that Sun and Jevic operated two distinct and separate businesses that were not dependent on each other, noting in particular that Jevic maintained separate books and records, had its own bank accounts, prepared its own financial statements, and did not share administrative services, facilities or equipment with Sun. The Bankruptcy Court also stated that Jevic's attempts to seek additional financing from outside lenders cut against a finding of financial dependency on Sun, and that Sun's attempts to "rescue" Jevic similarly did not constitute financial dependency.

The Litigation Against Jevic

That the WARN Act applied to Jevic, and that Jevic provided less than the required 60-day notice to its employees was not disputed. Nevertheless, the Bankruptcy Court granted Jevic's motion for summary judgment with respect to the plaintiffs' federal WARN Act claims, holding that the "Unforeseeable Business Circumstances" exception to the 60-day notice requirement in that statute applied.[14]

The Unforeseeable Business Circumstances exception under the federal WARN Act provides that "[a]n employer may order a plant closing or mass layoff before the conclusion of the 60-day period if the closing or mass layoff is caused by business circumstances that were not reasonably foreseeable as of the time that notice would have been required."[15] Any employer relying on this or any other exception must "give as much notice as is practicable and at that time shall give a brief statement of the basis for reducing the notification period."[16] The DOL regulations state that an unforeseeable business circumstance is one that is caused by "some sudden, dramatic and unexpected action or condition outside the employer's control."[17] Courts have held that the <u>probability</u> of occurrence makes a business circumstance reasonably foreseeable, rather than the mere <u>possibility</u> of occurrence.[18]

The Bankruptcy Court held that the lenders' refusal to extend their forbearance past mid-May 2008 was unforeseeable to Jevic as of March 20, 2008 (which is the time when Jevic would have had to deliver a WARN Act notice to comply with the 60-day requirement). The Bankruptcy Court noted that the lenders had repeatedly extended forbearance from December 2007 through April 2008, that Jevic had hired an investment bank to engage in a sale process, and that Jevic's outside consultant had projected (albeit incorrectly) that Jevic would be in compliance with its loan covenants through June 2008. Thus, although it was possible as of March 20, 2008 that the lenders would stop extending their forbearance period past mid-May, it was not probable. The Bankruptcy Court also held that the lenders' decision not to extend their forbearance period was outside Jevic's control. Although the lenders offered to extend the forbearance period if Sun invested new money in Jevic, Sun refused to do so and Jevic was not obligated to force Sun to change its mind.[19]

Conclusion

Although both decisions are now being appealed, they provide some valuable guidance to private equity firms and lenders to distressed portfolio companies. Notably, the third factor of the single employer test (de facto exercise of control) is probably the most important, at least at the motion to dismiss stage of litigation. Indeed, at least one court held that well-pleaded allegations of "particularly striking" control can prevent a parent or lender from prevailing in a motion to dismiss a WARN Act complaint, even if the plaintiff does not adequately allege the existence of most of the other four factors. Examples of such control by a parent or a lender could include making the decision for the subsidiary to shut down facilities, lay off its employees without 60 days' notice and enter bankruptcy.

To reduce potential WARN Act liability with respect to employee layoffs conducted by portfolio companies, private equity firms would be well-advised to respect the corporate separateness of their portfolio companies. Moreover, private equity firms and lenders should try their best to ensure that the portfolio companies themselves make significant decisions (particularly decisions regarding plant closures, terminations of employment and issuances of WARN Act notices). Particularly helpful strategies would include portfolio companies retaining their own attorneys and other professionals (who would advise the portfolio companies' management and boards, not the parent or the lenders) to assess and pursue restructuring or sale alternatives, and to advise the portfolio companies' management and boards regarding any employment and plant closure decisions.

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Endnotes

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[1] *Czyzewski, et al. v. Jevic Transportation, Inc. et al.*, Adv. Pro. No. 08-50662 (Bankr. D. Del.) [Docket No. 240].

[2] *Czyzewski, et al. v. Jevic Transportation, Inc. et al.*, Adv. Pro. No. 08-50662 (Bankr. D. Del.) [Docket No. 241].

[3] 29 U.S.C. § 2102(a)(1).

[4] 20 C.F.R. § 639.3(a)(2).

[5] 247 F.3d 471 (3d Cir. 2001).

[6] Sun argued that the second factor should be decided in its favor, because (a) Jevic's "senior management team" (rather than Jevic's board) controlled Jevic's daily operations and (b) no Sun directors or officers were on Jevic's "senior management team." The Bankruptcy Court rejected that argument, stating that the appropriate test is the presence of common *directors or officers*, not a common "senior management team."

[7] *See Pearson,* 247 F.3d 471 (3d Cir. 2001).

[8] *See Pearson*, 247 F.3d at 491; *In re APA Transp. Corp. Consol. Litig.*, 541 F.3d 233, 245 (3d Cir. 2008).

[9] *See Pearson*, 247 F.3d at 503.

[10] The Bankruptcy Court also noted that the WARN notice was signed by Jevic, and not by Sun.

[11] *See Pearson*, 247 F.3d at 499.

[12] *See APA Transp. Corp.*, 541 F.3d at 245.

[13] *See Pearson*, 247 F.3d at 500.

[14] The Bankruptcy Court ruled that the plaintiffs were entitled to recovery from Jevic under the New Jersey state WARN Act, which does not provide any exceptions to the 60-day notice required under that statute.

[15] 29 U.S.C. § 2102(b)(2).

[16] 29 U.S.C. § 2102(b)(3).

[17] See 20 C.F.R. § 639.9(b). Employers are expected to exercise commercially reasonable business judgment in predicting the demands of a particular market, but they are not required to accurately predict general economic conditions that might also affect demand for their products or services. *See id.*

[18] *See, e.g.*, *Watson v. Mich. Indus. Holdings, Inc.*, 311 F.3d 760, 765 (6th Cir. 2002).

[19] The Bankruptcy Court rejected Jevic's argument that the "Faltering Company" exception to the 60-day notice requirement also applied in this case, noting that that exception required Jevic to "actively seek capital" at the time the 60-day notice would have been required (i.e., March 20, 2008). Jevic indisputably was not actively seeking capital on or before March 20.