THE WARN ACT EXCEPTION YOU'VE NEVER HEARD OF

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I. INTRODUCTION

It is a scene with which we are all-too familiar: with consumer spending down and credit markets tightening (bailouts notwithstanding), companies that for months or years had been managing to "get by" find themselves suddenly unable to stay afloat. In recent weeks we have seen companies go from "cautiously optimistic" to declaring bankruptcy in record time. Compounding these companies' financial woes is the WARN Act, the federal law which requires employers to give their employees 60 days' notice before large-scale layoffs, or pay those employees the equivalent of those 60 days. This means employers forced to shut down without warning may have to pay their employees a full two months' salary—money that will be hard, if not impossible, to come by.

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A little-known exception to the WARN Act, however, may come to the rescue of these employers—the "liquidating fiduciary" exception. Never heard of it? You're not alone. This defense has, as yet, been used only sparingly, and even many seasoned employment lawyers are unaware of its existence. But it could save your company millions.

II. THE WARN ACT: A PRIMER

The Worker Adjustment and Retraining Notification Act[1] was passed in 1988 in response to extensive worker dislocation in the 1970s and 1980s, when companies often concealed projected plant closings and terminated their employees without any notice whatsoever. These closings were often devastating, not only for individuals and families, but for entire communities. The WARN Act is designed to provide employees a period of transition to adjust to the prospective loss of employment, to seek and obtain alternative jobs, and, if necessary, to enter skill training or retraining that will allow them to successfully compete in the job market.[2]

The Act attempts to accomplish this by requiring companies to provide at least 60-days' written notice to "affected employees" (or their representatives) of pending terminations when the number of employees to be terminated exceeds certain thresholds.[3] It applies to "plant closings," defined as "a shutdown of a single site of employment that causes an employment loss for fifty or more employees during a 30-day period,"[4] and "mass layoffs," which are any other work force reduction that results in an employment loss for either (1) 50 to 499 full-time employees, if the number laid off equals at least 33% of the work force, or (2) 500 or more full-time employees.[5]

Failure to comply with WARN's notice provision will expose an employer to liability of up to 60 days of back-pay for each affected employee. In other words, a covered employer is liable to each employee for back-pay (which may include benefits under certain employee benefit plans) for every day the company is deficient in providing the required 60-days notice.[6] These numbers can add up quickly.

Statutory WARN Act Defenses

The WARN Act itself includes three statutory "affirmative defenses"—mechanisms built into the Act itself to protect companies forced to layoff employees with less than 60-days prior notice. These exceptions are: 1) layoffs or plant closings caused by natural disasters, 2) the "faltering company" exception, and 3) the "unforeseeable business circumstances" exception.[7]

The "natural disasters" exception is self-explanatory—no prior notice is required where a layoff or plant closing is necessitated by a natural disaster. The "faltering company" and "unforeseeable business circumstances" exceptions, on the other hand, serve only to reduce the 60-day notice requirement, rather than eliminating the requirement altogether. Instead, these exceptions require an employer give "as much notice as is practicable."[8]

The "unforeseeable business circumstances" exception applies 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.[9] Specifically, it requires a sudden, dramatic, and unexpected action or condition outside the employer's control, such as a principal client's sudden and unexpected termination of a major contract, a strike at a major supplier of the employer, or an unanticipated and dramatic major economic downturn."[10]

The "faltering company" exception requires a company to prove: (1) it was actively seeking capital or business at the time the 60-day notice would have been required; (2) it must have had a realistic opportunity to obtain the sought after financing or business; (3) the financing or business sought must have been sufficient, if obtained, to postpone or prevent plant closing; and (4) it had to reasonably believe, in good faith, that giving the required notice would have precluded its ability to obtain the necessary financing or business.[11] This exception is intended to allow an employer to seek capital to avoid a shutdown, and is inapplicable where the closing and/or layoff occurred as a result of a failed sale of business.[12]

III. THE LIQUIDATING FIDUCIARY EXCEPTION

While not referenced in the statute or its regulations, there is a fourth exception to the WARN Act's standard 60-day notice rule—the "liquidating fiduciary" exception. Unlike the "faltering company" or "unforeseeable business circumstances" exceptions, which simply reduce an employer's notice obligations, this judge-made exception dictates that if an entity is a "liquidating fiduciary" when it terminates its employees, it need not give any prior notice of a pending plant closing or mass layoff.[13] As such, if a company can prove that it was a "liquidating fiduciary" at the time notice would have been required under the WARN Act, it will have no obligation to provide its former employees back-pay in lieu of notice as required under the WARN Act.

While this sounds like a boon to employers (and it might be), a few preliminary words of warning. First, while every exception to the WARN Act is narrowly construed, this is especially true with respect to the "liquidating fiduciary" exception. Judges are wary of limiting the scope of the WARN Act, particularly for an exception not specifically enumerated in the Act itself. Employers must beware that courts will conduct very intensive, fact-specific inquiries into events surrounding plant closings and/or mass layoffs where this exception is invoked.

Second, very few courts have addressed this issue at all, and, with respect to a company entering bankruptcy (rather than a secured creditor or outside fiduciary financing such a company) attempting to utilize this protection; there are less than five reported cases—and only one court, the Third Circuit in *In re United Healthcare System, Inc.* ("United Healthcare")[14]—has upheld its application.

Still, as this exception may be the only way a company can avoid WARN Act liability, knowledge of its intricacies is necessary.

"Employer" vs. "Liquidating Fiduciary"—The "Engaged in Business" Analysis

So what is a "liquidating fiduciary?" In short, it is a business that is no longer operating as a going concern, but is rather operating for the *sole purpose* of liquidating as part of the bankruptcy process. Such a business is not subject to the notice provisions of the WARN Act because it is no longer considered an "employer." Conversely, if the business, while engaged in the bankruptcy process, is still conducting its business operation—and therefore still an "employer"—the notice obligations under the WARN Act still apply. Accordingly, the first inquiry to address is what courts consider an "employer" for WARN purposes.

The WARN Act defines an "employer" as any business enterprise that employs (A) 100 or more employees, excluding part-time employees; or (B) 100 or more employees who in the aggregate work at least 4,000 hours per week (exclusive of hours of overtime)…[15]

Because this definition is not particularly revealing, courts have turned to the Department of Labor for help. The DOL, in the comments to its regulations implementing the Act, suggests that whether an entity (bankrupt or otherwise) is an "employer" under the WARN Act depends in part on the nature of the entity's activities. "The term 'employer,'" the DOL writes, "includes public and quasi-public entities which engage in business (*i.e.*, take part in a commercial or industrial enterprise, supply a service or good on a mercantile basis, or provide independent management of public assets, raising revenue and making desired investments)."[16] Accordingly, the relevant inquiry is whether the entity in question is "engaged in business," as defined.

The DOL provides further guidance into the relationship between WARN notice obligations and entities in bankruptcy at the time the closing or layoff occurred:

> [A] fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit of creditors does not succeed to the notice obligations of the former employer because the fiduciary is not operating a "business enterprise" in the normal commercial sense. In other situations, where the fiduciary may continue to operate the business for the benefit of creditors, the fiduciary would succeed to the WARN obligations of the employer precisely because the fiduciary continues the business in operation.[17]

Accordingly, a liquidating fiduciary is an entity no longer acting in a business capacity, or, more specifically, is solely focused on liquidating, and is therefore not responsible for any failure to provide notice prior to the liquidation process—even if the entity in question was formerly the company employing the terminated workers.

It is this language that courts have relied on in creating and defining the "liquidating fiduciary" exception. The Third Circuit Court of Appeals in *United Healthcare* outlined a sliding-scale analysis to be used when analyzing a bankrupt entity's activities to determine whether that entity is an "employer" under the Act:

> In light of the Department of Labor commentary to the regulations…we believe that whether a bankrupt entity is an "employer" under the WARN Act depends on the nature and extent of the entity's business and commercial activities while in bankruptcy, and not merely on whether the entity's employees continue to work "on a daily basis." The more closely the entity's activities resemble those of a business operating as a going concern, the more likely it is that the entity is an "employer"; the more closely the activities resemble those of a business winding up its affairs, the more likely it is the entity is not subject to the WARN Act.[18]

For more details about what this means and how the liquidating fiduciary exception will be applied, we turn to the few cases that have addressed the issue.

IV. APPLYING THE EXCEPTION—CASE COMPARISONS

A comparison of the Third Circuit decision in *United Healthcare*, where the exception was successfully invoked, and the decisions in *Law v. Am. Capital Strategies, Ltd.* ("Law")[19] and *In re Jamesway Corp.* ("Jamesway"),[20] where the exception was unsuccessfully argued before the Middle District of Tennessee and the Southern District of New York, respectively, is instructive.

In re United Healthcare

United Healthcare was a fully-functioning hospital in New Jersey with approximately 1,300 employees. Though it had experienced financial difficulties for several years, in 1996 it suffered substantial operating losses and had trouble maintaining essential supplies. Despite its difficulties, the company did not believe that its financial problems would force it to close, and the board of directors approved a budget for 1997 that projected positive revenues by year-end. But the company's financial problems worsened in 1997, and its secured creditor suspended funding (notwithstanding ongoing negotiations with a potential buyer). Without this funding, United Healthcare was unable to meet its operating expenses. It closed its emergency room and reduced its number of patients. Ultimately, the secured creditor issued a notice of default and terminated all financing.

United Healthcare filed for Chapter 11 bankruptcy in February 1997, and simultaneously

(1) provided WARN notice to its employees, explaining its intent to terminate them 60-days subsequent, and (2) discharged or transferred all of its patients to another hospital.

In the following weeks, United Healthcare employees, no longer able to perform their usual duties, cleaned, took inventory, and prepared the company's assets for sale. But despite being told they had 60 days until their termination, United Healthcare terminated them after only 16 days. This action left a possible WARN obligation for 44 days of back pay totaling $5.1 million.

After the district court held that United Healthcare was subject to the WARN Act and, therefore, its employees were entitled to 60 days of back pay, the Third Circuit overturned the decision, finding that United Healthcare was not subject to WARN Act liability because it conducted itself not as a business operating as a going concern, but rather as a business liquidating its affairs. In other words, the Court determined that United Healthcare was a fiduciary, rather than an employer covered by the WARN Act. The Court noted that: (i) within 48 hours of filing for bankruptcy, United Healthcare discharged or transferred all its patients, and was no longer admitting new patients; (ii) after filing for bankruptcy, its employees were no longer engaged in their regular duties but instead were performing tasks solely designed to prepare United Healthcare for liquidation; and (iii) United Healthcare did not file for bankruptcy in an effort to avoid its WARN Act responsibilities.[21]

Law v. Am. Capital Strategies, Ltd.[22]

On May 5, 2005, Service Transport permanently shut down five of its facilities and notified its 750 employees that they would be terminated 20 days later. Until the shutdown on May 5, 2005, Service Transport operated in its usual capacity. Though the company (and its parent, American Capital) knew as early as December 2004 that bankruptcy and liquidation was a possibility, at no time prior to orchestrating the shutdowns (and indeed, following the shutdowns) did they operate the business for the sole purpose of liquidation.

Toward the end of April 2005, a potential buyer prepared a draft letter of intent to purchase the assets of Service Transport, and indicated it would agree to hire the Service Transport employees. Negotiations continued through May 3, 2005—but no final contract was ever executed, and on May 4, 2005, American Capital made the decision to shut down Service Transport and terminate its employees 21 days later.

Following this decision, Service Transport continued to deliver shipments, and, by May 25, 2005, when it terminated its employees, the company still had not filed for bankruptcy protection.

Relying on the decision in *United Healthcare*, American Capital argued that it was not a covered employer under the WARN Act, but was rather a "liquidating fiduciary." The court rejected this argument noting that, unlike United Healthcare, at the time the decision to terminate the employees was made, Service Transport was still operating its trucking business. The company had not filed a petition for bankruptcy when the WARN Act notices were sent. As such, it was not a "liquidating fiduciary." Although American Capital had a loose exit strategy which included a stated intent to liquidate its assets, Service Transport had not taken any specific steps to begin the liquidation.

The Court emphasized that the liquidating fiduciary exception should be narrowly construed. The exception should not be applied, the court wrote, where an employer takes only preliminary steps towards liquidation, while otherwise continuing to carry on its business. If the exception were applied so broadly, it would essentially swallow the rule, allowing companies an easy escape from their WARN obligations whenever liquidation was a possibility.

In re Jamesway Corp.[23]

Jamesway first considered the possibility of filing for bankruptcy for the purpose of liquidating on September 29, 1995, and sought the advice of counsel on potential WARN Act liability. On October 6, 1995, the company sent a press release announcing that it was considering filing a chapter 11 bankruptcy petition. On October 12, 1995, six days prior to filing for bankruptcy, Jamesway began terminating its employees without notice. Jamesway continued its operations for a short period, and remained in possession and control of its business and assets as a debtor in possession until June 1997, when it confirmed a Joint Liquidating Plan of Reorganization.

Jamesway attempted to utilize the liquidating fiduciary exception, arguing that it was operating solely to liquidate its affairs in anticipation of bankruptcy. The

Court, however, did not even address this issue. The Court held that as of October 12, Jamesway had identified which employees would lose their jobs in the ensuing liquidation, and formulated a schedule for firing them. As such, even if Jamesway was a "liquidating fiduciary" on October 18, 1995 when it filed for bankruptcy, it was nevertheless liable to its employees under the WARN Act because they were "affected employees" (*i.e.*, employees who may reasonably be expected to experience an employment loss as a consequence of a proposed plant closing or mass layoff) as of October 12, 1995, the day terminations began. In other words, because Jamesway terminated its employees before filing for bankruptcy, it was subject the WARN Act, and the subsequent bankruptcy filing did not divest Jamesway of its obligations under WARN.

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As the caselaw indicates, the key inquiry when applying the liquidating fiduciary exception is the nature and extent of the entity's business and commercial activities at the time the company knew it would conduct a mass-layoff of plant closing. The more closely the entity's activities resemble those of a business operating as a going concern, the more likely it is that the entity is a "regular" employer subject to the WARN Act; the more closely the activities resemble those of a business winding up its affairs, the more likely it is not.

In *United Healthcare*, the company filed for bankruptcy and *simultaneously* (1) provided valid WARN notice to its employees, intending to terminate them 60 days thereafter, and 2) transferred all its patients to another hospital within two days. Its employees, though continuing to work for the company, merely performed tasks such as cleaning, taking inventory, and preparing the company for the upcoming asset sale.

Conversely, in *Law,* American Capital provided its employees 20 days' notice of their terminations, but continued to operate its business after providing the notice of termination and did not file for bankruptcy. Similarly, in *Jamesway*, the company terminated a majority of its employees without notice, but did not file for bankruptcy until a week later. Timing is crucial.

Also important is intent. Had United Healthcare acted in bad faith or not been "up front" with its employees, it may not have been able to escape WARN liability. As the court wrote:

> In this case, there is no evidence United Healthcare knew in advance that it would be forced to close but concealed that knowledge from its employees. Instead, the record demonstrates that United Healthcare made repeated and intensive good-faith efforts to remain financially viable and to ensure its employees would keep their jobs. Furthermore, United Healthcare willingly disclosed its financial difficulties to its employees, including them in its efforts to find a merger partner. Clearly, United Healthcare did not file for bankruptcy in an effort to avoid its WARN Act responsibilities.[24]

V. GENERAL GUIDELINES

Despite the dearth of caselaw on the subject, we see some general rules emerge for companies wishing to utilize the "liquidating fiduciary" exception.

- Keep employees apprised of the general financial condition of the company—including any merger or outside financing attempts.
- When the decision is made to file for bankruptcy and liquidate, cease business as usual to focus on liquidation. Having a general liquidation plan is not enough—the actual activities of a company are the deciding factor (compare United Healthcare's transfer of its patients and employee tasks to American Capital's decision to continue making deliveries.
- If possible, terminate employees simultaneous to filing for bankruptcy (compare *United Healthcare* and *Jamesway*). If the bankruptcy filing date is after the date you began the liquidation process, it may be prudent to provide some form of notice between the date you began liquidating and the date of filing.
- Any employee still working at the company after beginning the liquidation process should cease their usual responsibilities, and their tasks should be solely focused on preparing for liquidation, as in *United Healthcare*—*i.e.* cleaning and conducting inventory.

VI. CONCLUSION

The liquidating fiduciary exception to the WARN Act has very high standards, and it will be difficult for many employers to meet its criteria. For those that can, though, it can be hugely beneficial, and thus should have a place in every struggling company's arsenal.

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NOTES

1. 29 U.S.C.A. § 2101 et seq.
2. 20 C.F.R. 639.1(a); Hotel Employees and Restaurant Employees Intern. Union Local 54 v. Elsinore Shore Assoc., 173 F.3d 175, 182 (3d Cir. 1999).
3. 29 U.S.C.A. § 2101 et seq.
4. 29 U.S.C.A. § 2101(a)(2).
5. 29 U.S.C.A. § 2101(a)(3).
6. 29 U.S.C.A. § 2104.
7. 29 U.S.C.A. § 2102(b).
8. 29 U.S.C.A. § 2102(b).
9. 29 U.S.C.A. § 2102(b)
10. 20 C.F.R. § 639.9(b).
11. 29 U.S.C.A. § 2102(b); 20 C.F.R. § 639.9(a).
12. Law v. American Capital Strategies, Ltd., 2007 WL 221671 (M.D. Tenn. 2007).
13. 29 U.S.C.A. § 2102(b); In re Jamesway Corp., 13 I.E.R. Cas. (BNA) 73, 1997 WL 327105 (Bankr. S.D. N.Y. 1997); Chauffeurs, Sales Drivers, Warehousemen & Helpers Union Local 572, International Brotherhood of Teamsters, AFL-CIO v. Weslock Corp, 66 F.3d 241, 244 (9th Cir. 1995).
14. In re United Healthcare System, Inc., 200 F.3d 170, 35 Bankr. Ct. Dec. (CRR) 105, 15 I.E.R. Cas. (BNA) 1470, 140 Lab. Cas. (CCH) P 10628 (3d Cir. 1999).
15. 29 U.S.C. § 2101.
16. 20 C.F.R. § 639.3(a)(1)(ii); 54 FED. REG. 16042, 16045.
17. 54 Fed. Reg., at 16045.
18. In re United Healthcare System, Inc., 200 F.3d 170, 178, 35 Bankr. Ct. Dec. (CRR) 105, 15 I.E.R. Cas. (BNA) 1470, 140 Lab. Cas. (CCH) P 10628 (3d Cir. 1999).
19. Law v. American Capital Strategies, Ltd., 2007 WL 221671 (M.D. Tenn. 2007).
20. In re Jamesway Corp., 13 I.E.R. Cas. (BNA) 73, 1997 WL 327105 (Bankr. S.D. N.Y. 1997).
21. Although United Healthcare filed under Chapter 11, ordinarily used to reorganize, rather than Chapter 7, generally used to liquidate, the Third Circuit determined that United Healthcare's actions while in bankruptcy "clearly demonstrate[d] its intent to liquidate," *i.e.,* simultaneously filing for bankruptcy, surrendering its certificates of need, and agreeing to sell its assets and goodwill to the purchaser.
22. Law v. American Capital Strategies, Ltd., 2007 WL 221671 (M.D. Tenn. 2007).
23. In re Jamesway Corp., 235 B.R. 329 (Bankr. S.D. N.Y. 1999).
24. In re United Healthcare System, Inc., 200 F.3d 170, 179, 35 Bankr. Ct. Dec. (CRR) 105, 15 I.E.R. Cas. (BNA) 1470, 140 Lab. Cas. (CCH) P 10628 (3d Cir. 1999).