Employee Issues in Chapter 11

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I. INTRODUCTION

This outline discusses select employee issues seen in Chapter 11 cases. It covers issues such as the treatment of pre-petition wages, salary, commission; and vacation pay obligations; the priority of terminated employees' severance claims; insider and non-insider employment agreements; post-petition severance or Key Employment Retention Payment plans; and certain WARN Act issues.

II. PRE-PETITION CLAIMS FOR WAGES, SALARY, COMMISSION, VACATION PAY AND CONTRIBUTIONS TO EMPLOYEE BENEFIT PLANS

Pursuant to Bankruptcy Code sections 507(a)(4) and (a)(5), employees' allowed unsecured claims for wages, salaries, commissions and contributions to employee benefit plans that are earned or arise from services rendered within a certain time period are entitled to priority status up to a certain amount. Sections 507(a)(4) and (a)(5) provide:

> (a) The following expenses and claims have priority in the following order:
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> **(4)** Fourth, allowed unsecured claims, but only to the extent of $11,725 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for--
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> > **(A)** wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or
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> > **(B)** sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor.
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> **(5)** Fifth, allowed unsecured claims for contributions to an employee benefit plan--

> **(A)** arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only
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> **(B)** for each such plan, to the extent of--
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> > **(i)** the number of employees covered by each such plan multiplied by $11,725; less
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> > **(ii)** the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

"By assuring employees of the debtor of a greater likelihood of payment for prepetition labor, it is believed that the employees are more likely to continue their employment, thus preventing dissipation of the debtor's business and preserving or increasing the proceeds that the case can generate for payment of creditors." 4 COLLIER ON BANKRUPTCY ¶ 507.02[1][d] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). There is also public policy reasoning behind such priorities for employees. Because employees rely on the debtor as their only source of income, and through their labor have helped to create the assets of the estate, employees are viewed as having a special right to payment for those claims covered by sections 507(a)(4) and (a)(5). Id.

A. Priority Claim Amount Limits

As of April 1, 2010, the section 507(a)(4) statutory maximum an employee can assert as a priority claim for his or her pre-prepetition wages, salaries or commissions was increased to $11,725.[1] Matson v. Alarcon, 651 F.3d 404, 408 (4th Cir. 2011). On April 1, 2013, and every three years thereafter, the statutory maximum of section 507(a)(4) will be adjusted:

> **(1)** to reflect the change in the Consumer Price Index for All Urban Consumers, published by the Department of Labor, for the most recent 3-year period ending immediately before January 1 preceding such April 1, and
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> **(2)** to round to the nearest $25 the dollar amount that represents such change.

11 U.S.C.A. § 104.

[1] The previous dollar limit in Section 507(a)(4) was $10,950.

B. Time Limitation

Section 507(a)(4) limits employees' priority claims for wages, salaries or commissions to those wages, salaries or commissions that are *earned* within 180 days from the filing of the petition or the cessation of a debtor's business. See Belson v. Olson Rug Co., No. 12 C 4474, 2012 WL 4513491 (N.D. Ill. Oct. 1, 2012) ("For any portion of an employee or former employee's claim to be entitled to priority under section 507(a)(4) the wages, salaries, or commissions must have been *earned* within 180 days before the filing of the petition. Such claims are 'earned' under an employment arrangement no later than the termination of the individual's employment.") (internal citations omitted).

While Section 507(a)(4) does not specifically define the word "earned," courts have observed the term to "encompass the common understanding of the manner in which employees 'earn' wages, salaries, and commissions . . . Employees typically receive such compensation in exchange for their employment performance . . . The triggering events permitting employees to receive wages, salaries, and commissions generally lie within the employees' control upon performance of their work, subject to the terms of the employment agreement." Matson v. Alarcon, 651 F.3d 404, 408 (4th Cir. 2011).

While wages are easily determined to be earned within 180 days merely by a showing of performance, other claims, such as bonuses, are not. "Entitlement to a bonus alone does not establish a priority claim." In re Cardinal Indus., Inc., 160 B.R. 83, 85-86 (Bankr. S.D. Ohio 1993). The mere fact that the bonus might not have been approved for payment or paid until after the services were rendered does not alter the time when it was "earned" for purposes of 11 U.S.C. § 507(a)(4). Id. Bonuses are deemed to be earned at the time in which the services giving rise to the right of payment are performed. Id. "The term 'earned' has a fixed meaning which does not change based upon a particular company's policy regarding the time for payment of such bonuses," and so long as the services are performed within the 180 day limit, the bonus will be given priority under Section 507(a)(4). Id.

C. Section 507(a)(4) - Wages, Salaries and Commissions

i. Section 507(a)(4)(A) - Wages, Salaries, and Commissions, Including Vacation, Severance, and Sick Leave Pay

The scope of the priority covers "all types of wages, however they may be denominated in the contract or employment relationship between the debtor and the employee. It includes regular salaries, whether the employee is paid by the hour, the week or the month. It covers bonuses so long as the bonus is in the nature of compensation for the work performed." 4 COLLIER ON BANKRUPTCY ¶ 507.06[2][2] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). No matter how commissions are calculated, the priority also covers those claims of employees who are paid based on "what they produce rather than by the time they spent working." Id.

Section 507(a)(4) does not include "fringe benefits," such as employer contributions to life insurance and annuity benefits, nor does it include "perks" of employment, such as stock options. Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 126 S.Ct. 2105, 165 L.Ed. 2d 110 (2006); Matter of Baldwin-United Corp., 52 B.R. 549, 551 (Bankr. S.D. Ohio 1985)("As a factual matter the stock option rights are not in the nature of wages . . ."); see also 4 COLLIER ON BANKRUPTCY ¶ 507.06[2][2] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). Workers compensation is also not included under section 507(a)(4). Howard Delivery, 547 U.S. at 651; see also 4 COLLIER ON BANKRUPTCY ¶ 507.06[2][2] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.).

"By specifically including vacation with other types of monetary compensation," the courts have concluded that "Congress intended for vacation pay to be treated as a type of wage." In re Crafts Precision Indus., Inc., 244 B.R. 178, 182-83 (B.A.P. 1st Cir. 2000); see also 2E Bankr. Service L. Ed. § 25:146 (Vacation pay cannot be regarded as "fringe benefit" or as "contribution to an employee benefit plan, and should only be considered under "wages."). Therefore, any vacation pay earned within the 180 days prior to the date of filing will qualify for Section 507(a)(4) priority. Id.

In some companies, employees are not entitled to vacation pay benefits until the anniversary of their date of hiring, commonly referred to as the "eligibility date." As a result, some employees become entitled to a full year's vacation pay during the priority period if their eligibility date falls within the period, or none at all if it falls outside of the period. In re Ground Round, Inc., 316 B.R. 423, 428 (Bankr. D. Mass. 2004). To remedy this discrepancy for priority purposes, bankruptcy courts have permitted a compromise by which the vacation pay can be treated as earned evenly throughout the year. Id.; see also 2E Bankr. Service L. Ed. § 25:146.

Severance benefits are typically payments due to an employee as compensation for the termination of the employee's employment, in lieu of notice of termination, or under an employment contract. See 4 COLLIER ON BANKRUPTCY ¶ 507.06[5][b] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). The same 180 day period applies in order for a severance benefit to be deemed "earned" within the statutory limits imposed by section 507(a)(4). When severance benefit claims arise due to a loss of employment, the typical approach to determine what portion was earned within the 180 days prior to filing is to "take a fraction of the total severance benefits payable and multiply the total by a fraction, the numerator of which is 180 and the denominator is the total period over which severance benefits vested in the employee." 4 COLLIER ON BANKRUPTCY ¶ 507.06[5][b][i] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.) (citing Roeder v. United Steelworkers (In re Old Electralloy Corp.), 167 B.R. 786 (Bankr. W.D. Pa. 1994); In re Yarn Liquidation, Inc., 217 B.R. 544 (Bankr. E.D. Tenn. 1997).

Severance payments provided in lieu of notice of termination only become due if the employee is terminated without notice. This type of severance claim is earned at the time the employee is terminated. See 4 COLLIER ON BANKRUPTCY ¶ 507.06[5][b][ii] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). Therefore, if the employee is terminated without notice during the 180 days prior to the bankruptcy filing, the employee is entitled to claim section 507(a)(4) priority. As for employment contracts in which employees are entitled to severance for termination prior to a set date, priority entitlement is dependent on when the employee was terminated. Id. In those instances in which an employee is terminated after the bankruptcy filing, the courts typically deem the severance "earned" at the time the contract was executed. Id. (citing Dullanty v. Selectors, Inc. (In re Selectors, Inc.), 85 B.R. 843 (B.A.P. 9th Cir. 1988); In re M Group, Inc., 268 B.R. 896 (Bankr. D. Del. 2001); In re Uly-Pak, Inc., 128 B.R. 763 (Bankr. S.D. Ill. 1991). Therefore, if the contract was executed before 180 days prior to the bankruptcy filing, the former employee will not be entitled to priority. See In re M Group, Inc., 268

B.R. 896 (Bankr. D. Del. 2001); In re Uly-Pak, Inc., 128 B.R. 763 (Bankr. S.D. Ill. 1991). In situations where the employee was terminated prior to the bankruptcy filing, the courts have found the severance "earned" at the time of termination. In re Ellipsat, Inc., 480 B.R. 1, 11 (Bankr. D.C. 2012) (citing In re Garden Ridge Corp., No. 04-10324 (KJC), 2006 WL 521914 (Bankr. D. Del. Mar. 2, 2006)).

ii. Are Independent Contractors Covered By Section 507(a)(4)?

In years past, there was a divide among the courts as to whether the priority of section 507(a)(4) was limited to employees only, or whether independent contractors could also assert such claims. In recent years, courts have moved toward allowing independent contractors and other non-employees of the debtor to receive wage priority status under section 507(a)(4). See In re Corcoran, No. 10-00741, 2010 WL 5207589 (Bankr. D. Haw. Dec. 16, 2010).

In the case of In re Corcoran, the bankruptcy court found that "[p]riority status under section 507(a)(4)(A) does not turn upon whether the claimant was an 'employee' under nonbankruptcy law." Id. The court reasoned that the statute does not expressly restrict the assertion of wage priority to employees, as the only limitations are on the sums and the time period of the claimed wages. Id. Other cases have similarly ruled that non-employees and independent contractors are entitled to priority wage claims. See In re Wang Laboratories, Inc., 164 B.R. 404, 408 (Bankr. D. Mass. 1994) ("Congress intended similarly to open the scope of 'wages' to include compensation paid to such persons, whether employees or independent contractors."); In re Qualia Clinical Serv., Inc., No. BK09-80629-TJM, 2009 WL 2513820 (Bankr. D. Neb. Aug. 10, 2009) (accepting the "expansive interpretation of the scope of individuals covered by the wage priority statute" to include non-employees and independent contractors).

Thus, it is immaterial whether the person seeking a priority wage, salary or commission claim is an employee, an independent contractor, or even a non-employee, so long as the limitations provided by section 507(a)(4) are established.

iii. Section 507(a)(4)(B) - Sales Commissions Earned by Independent Contractors

Sales commissions are included within those claims for which an employee can seek section 507(a)(4) priority. "Section 507(a)(4)(B) contemplates sales commissions earned by sales representatives *of a debtor*." In re Viva Vista Ventures, Inc., No. 09-32313, 2010 WL 3366408 (Bankr. N.D. Ohio Aug. 23, 2010) (emphasis in original). Section 507(a)(4)(B) "determines whether an independent contractor is sufficiently similar to an employee to qualify for the wage priority." In re Haymarket Transp., Inc., No. 09-20389-SSM, 2011 WL 1871112 (Bankr. E.D. Va. May 16, 2011).

In order for independent contractor commissions to qualify for the priority, "the independent contractor must have been acting as such for the debtor with regard to the sale of goods or services in the ordinary course of the debtor's business. In addition, during the 12 months preceding the earlier of the date of the filing of the petition or the cessation of the debtor's business, the independent contractor must have earned from the debtor at least 75 percent of the total amount earned by such independent contactor from the sale of goods or services." 4 COLLIER ON BANKRUPTCY ¶ 507.06[3][b] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). The priority claims of independent contractor sales commissions are subject to the same monetary and time limitations as wages and salaries. See Meyers v. Heffernan, 740 F. Supp. 2d 637, 648 (D. Del. 2010).

D. Contributions to Employee Benefit Plans Under Section 507(a)(5)

The pre-petition "wages, salaries and commissions" covered by section 507(a)(4) do not include "fringe benefits," such as employer contributions to life insurance and annuity benefits. Howard Delivery, 547 U.S. at 651. To attend to this discrepancy, section 507(a)(5) was created to give a lower creditor priority status to fringe benefit claims. "Beyond genuine debate, the main focus of § 507(a)(5) is to capture portions of employee compensation for services rendered not covered by § 507(a)(4)." Id. at 659.

For purposes of the monetary cap, claims for contributions to employee benefit plans under section 507(a)(5) are combined with the priority claims under section 507(a)(4). Id. ("Linkage of subsections (a)(4) and (a)(5) by imposing a combined cap on the two priorities"). Specifically, employees are entitled to a priority claim in an amount equal to the number of employees covered by the benefit plan multiplied by $11,725 less the total amount paid to such employees under section 507(a)(4), plus the aggregate amount paid by the debtor on behalf of such employees to any other employee benefit plan. See 11 U.S.C. § 507(a)(5)(B).

To be entitled to priority status under section 507(a)(5) for claims based on contributions to employee benefit plans, there is no requirement that the employees be active or current employees of the debtor at the time of the bankruptcy filing, so long as they rendered services during the 180 day period imposed under section 507(a)(5). In re Consol. Freightways Corp. of Delaware, 564 F.3d 1161, 1167 (9th Cir. 2009) ("The operative principle is that the priority is for those who rendered services during the 180-day period, whether they were retired or not at the moment of the filing of the bankruptcy petition.").

As the statute fails to define "employee benefit plan," the courts have taken various approaches to outlining which plans properly fit within the protection of section 507(a)(5). While some bankruptcy courts have applied the "employee benefit plan" definition found in the Employee Retirement Income Security Act (ERISA)[2], the circuit courts have generally rejected this approach, as the "two pieces of legislation [ERISA and the priority scheme of the Bankruptcy Code] serve different and non-overlapping purposes." In re Birmingham-Nashville Exp., Inc., 224 F.3d 511, 517 (6th Cir. 2000). The U.S. Supreme Court noted that as the Bankruptcy Code often contains specific reference to definitions found in other federal legislation, and no such reference is contained in section 507(a)(5), the courts are not to read such definitions into section 507(a)(5). Howard Delivery, 547 U.S. at 652 ("No such directions are contained in §507(a)(5), and the Court has no warrant to write them into the text.").

There was also debate among the circuits as to whether workers' compensation is also included within the scope of "employee benefit plans." The U.S. Supreme Court addressed this issue in Howard Delivery:

> Unlike pension plans or group life, health, and disability insurance-negotiated or granted to supplement, or substitute for, *wages*-workers' compensation prescriptions modify, or substitute for, the common-law tort *liability* to which employers were exposed for work-related *accidents* …
> the Court is guided by the Bankruptcy Code's objective of securing equal distribution among creditors, and by the corollary principle that preference provisions must be tightly construed … The Bankruptcy Code caps the amount recoverable for contributions to employee benefit plans. Opening the § 507(a)(5) priority to workers' compensation carriers could shrink the

[2] See 29 U.S.C.A. §§ 1002(1)-(3) and 1003.

> amount available to cover unpaid contributions to plans paradigmatically qualifying as wage surrogates, primarily pension and health benefit plans.

547 U.S. at 653. Thus, those claims recoverable under the "employee benefit plan" language of section 507(a)(5) do not include worker's compensation claims.

E. First Day Motions: Motion for Authority to Pay Employees' Pre-Petition Wages, Related Expenses, and Benefits

Traditionally, on the filing date, Chapter 11 debtors with employees will file a "first day" motion seeking authority to pay their employees' pre-petition wages, commissions, salaries, expenses and benefits. The purpose behind this motion is to promote continuing loyalty and service of the debtor's employees because, without the continuing effort of the employees, a debtor's reorganization effort may be seriously jeopardized, if not doomed, from the onset of the bankruptcy case.

Although technically not specifically authorized by the text of the Bankruptcy Code, bankruptcy courts have authorized debtors to pay employees' pre-petition wages and benefit claims pursuant to 11 U.S.C. § 105(a) and the "necessity of payment" doctrines developed in early railroad reorganization cases.

Courts focus on the fact that those employees would have priority claims under sections 507(a)(4) and (a)(5) for the pre-petition amounts the debtor is seeking to pay the employees. In re Tusa-Expo Holdings, Inc., No. 08-45057-DML-11, 2008 WL 4857954, *2 (Bankr. N.D. Tex. Nov. 8, 2008) (emphasizing the importance of entitlement to priority treatment in determining whether a prepetition unsecured claim may be paid at the initial stages of a chapter 11 case; determined that employees should receive payment of prepetition wages and benefits).

Many courts do, however, authorize debtors to pay their employees amounts in excess of the statutory limitations set forth in sections 507(a)(4) and (a)(5). As the court recognized in In re Chateaugay Corp., 80 B.R. 279, 287 (S.D.N.Y. 1987), "a rigid application of the priorities of Section 507 would be inconsistent with the fundamental purpose of reorganization and of the Act's grant of equity powers to bankruptcy courts, which is to create a flexible mechanism that will permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately." See also In re Gulf Air, Inc., 112 B.R. 152 (Bankr. W.D. La. 1989) (authorizing payment of pre-petition amounts due, *inter alia*, for wages, benefits, health insurance premiums and per diem expenses under the "necessity of payment doctrine," without regard to statutory priorities of section 507).

III. TERMINATION OF EMPLOYMENT CONTRACTS

Section 502(b)(7) describes the maximum allowable general unsecured claim of an employee for damages resulting from the debtor's termination of the employee's employment contract. 4 COLLIER ON BANKRUPTCY ¶ 502.03[8][b] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.). The goal of section 502(b)(7) is to prevent unfair distributions in favor of former employees, "particularly those in positions of authority who may have had the opportunity to engineer or influence favorable terminations in anticipation of the company's bankruptcy." *Corporate Counsel's Guide to Employment Contracts*, §5:2; see also In re Lavelle Aircraft Co., No. 94-17496DWS, 1996 WL 226852, *5 (Bankr. E.D. Pa. May 2, 1996) ("§ 502(b)(7) serves a similar purpose by limiting employee damage claims, especially those of officers, owner-managers and other key-executives who had been able to exact favorable long term contracts calling for substantial remuneration.").

Section 502(b)(7) provides:

> **(b)** Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that--
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> **(7)** if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds--
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> **(A)** the compensation provided by such contract, without acceleration, for one year following the earlier of—
> **(i)** the date of the filing of the petition; or
> **(ii)** the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

> **(B)** any unpaid compensation due under such contract, without acceleration, on the earlier of such dates.

11 U.S.C. § 502(b)(7).

For a claim to fall under section 502(b)(7), the former employee must have an employment contract with the debtor. See In re VeraSun Energy Corp., 467 B.R. 757, 763 (Bankr. D. Del. 2012) ("To decide whether the § 502(b)(7) cap applies to the Executives' claims here, the Court first considers whether the CIC Agreements are 'employment contracts' under § 502(b)(7)."). "An agreement is an 'employment contract,' within the purview of 11 U.S.C. § 502(b)(7), if it establishes the terms and conditions of an employment relationship. No actual services need be performed under such an agreement to qualify as an employment contract." In re The Charter Co., 82 B.R. 144, 146 (Bankr. M.D. Fla. 1988) (internal citations omitted); see also In re VeraSun Energy Corp., 467 B.R. at 763.

"This section caps an employee's claim for damages resulting from the termination of an employment agreement when the employer has filed for bankruptcy to (1) one year's compensation provided by such agreement measured from the earlier of the date of the filing of the bankruptcy petition or the date of termination, plus (2) any unpaid compensation due on such date." In re WorldCom, Inc., 361 B.R. 675, 681 (Bankr. S.D.N.Y. 2007). "The one-year limitation in combination with the prohibition of acceleration provisions tends to prevent intended or unintended windfalls to the employee at the expense of the estate's general unsecured creditors." *Corporate Counsel's Guide to Employment Contracts*, §5:2; see also In re Visiting Nurse Ass'n, 176 B.R. 748, 751 (Bankr. E.D. Pa. 1995).

IV. INSIDER COMPENSATION

A. Local Rules on Compensation of Insiders [Why A but no B?]

"Bankruptcy courts in some jurisdictions have adopted special procedures regarding compensation of . . . 'insiders' in bankruptcy proceedings." *A Practical Guide to Bankruptcy*, Ch. 4-F. "In some jurisdictions, these 'insiders' cannot be paid from the estate unless court approval is obtained or notice is given to the U.S. Trustee and creditors, and no objection is raised." Id. For example, Bankruptcy Local Rule 2016-2 of the Western District of Louisiana prohibits compensation or other remuneration to be paid from assets of the debtor to "any present or former insider, affiliate, officer, director or equity security holder as set forth in 11 U.S.C. § 101"[3] without court authority. The local rule requires any application to pay compensation to an insider to be accompanied by a sworn disclosure by the insider of all previous compensation he or she received, from any source, for services related to the debtor's proceeding.

Other local rules allow compensation to insiders to continue, subject to creditors having a right to challenge the compensation by filing a motion to discontinue it. For instance, Local Bankruptcy Rule 4002-1 of the Eastern District of Pennsylvania permits a debtor to pay compensation to insiders, such as members of a partnership or an officer of a corporation, but allows creditors the right to file a motion to terminate the compensation. As bankruptcy courts' local rules differ on the issue, it is important that

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[3] Section 101(31) of the Bankruptcy Code defines "insiders" as follows:

> **(31)** The term "insider" includes--
> > **(A)** if the debtor is an individual--
> > > **(i)** relative of the debtor or of a general partner of the debtor;
> > > **(ii)** partnership in which the debtor is a general partner;
> > > **(iii)** general partner of the debtor; or
> > > **(iv)** corporation of which the debtor is a director, officer, or person in control;
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> > **(B)** if the debtor is a corporation--
> > > **(i)** director of the debtor;
> > > **(ii)** officer of the debtor;
> > > **(iii)** person in control of the debtor;
> > > **(iv)** partnership in which the debtor is a general partner;
> > > **(v)** general partner of the debtor; or
> > > **(vi)** relative of a general partner, director, officer, or person in control of the debtor;
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> > **(C)** if the debtor is a partnership--
> > > **(i)** general partner in the debtor;
> > > **(ii)** relative of a general partner in, general partner of, or person in control of the debtor;
> > > **(iii)** partnership in which the debtor is a general partner;
> > > **(iv)** general partner of the debtor; or
> > > **(v)** person in control of the debtor;
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> > **(D)** if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
> > **(E)** affiliate, or insider of an affiliate as if such affiliate were the debtor; and
> > **(F)** managing agent of the debtor.

11 U.S.C. §101(31).

the appropriate local rules be reviewed before *any* payments are made to insiders once a Chapter 11 bankruptcy case is filed.

V. POST-PETITION SEVERANCE OR KERP PLANS

"To successfully reorganize under Chapter 11, a debtor in possession may have particular need to retain key employees during the interim period between the petition date and the confirmation of a Plan of Reorganization," as well as post-confirmation. Rebecca Revich, The Kerp Revolution, 81 Am. Bankr. L.J. 87 (2007). Many chapter 11 debtors have sought authority to implement Key Employee Retention Payment (KERP) plans to minimize the possibility of employee departure. "These compensation arrangements may include a variety of incentives such as enhanced compensation during the period before confirmation of a Reorganization Plan, severance payments if the employee is involuntarily terminated, indemnity for post-petition conduct, and bonus payments tied to a successful reorganization. Most importantly, payments under a KERP receive administrative priority under §§ 503(b)(1)(A) and 507(a)(2)." Id. at 88.

In the early 2000s, KERPs "fell under congressional scrutiny … after several large corporations filed for bankruptcy protection in the wake of widespread internal fraud." Dorothy Hubbard Cornwell, To Catch A Kerp: Devising A More Effective Regulation Than § 503(c), 25 Emory Bankr. Dev. J. 485 (2009). Congress disapproved of large bonuses being paid to corporate executive while the lower level employees and stockholders lost their jobs, benefits, retirement funds and investments. To curb such unjust and asymmetrical distributions within companies, Congress added section 503(c)[4]

[4] Section 503(c) states:

(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid--

> **(1)** a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that--
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> > **(A)** the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
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> > **(B)** the services provided by the person are essential to the survival of the business; and
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> > **(C)** either--
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> > > **(i)** the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in

to the Bankruptcy Code which would substantially regulate KERPs to protect non-executive employees. Id. Section 503(c) was also passed "to limit a debtor's ability to favor insiders over the interests of the estate in a chapter 11 case." 4 COLLIER ON BANKRUPTCY ¶ 503.17[1] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.).

As KERP payments are made outside of the ordinary course of business, court approval of a KERP is necessary. See Bethany C. Suhreptz, Key Employee Retention Plans, Executive Compensation, and Bapcpa: No Rest for Congress, No More for Execs, 35 Wm. Mitchell L. Rev. 1194, 1198-99 (2009). In order to gain court approval, KERP plans must "satisfy the particular limitations of [11 U.S.C.] § 503(c)." The Kerp Revolution, 81 Am. Bankr. L.J. at 88.

Section 503(c) performs three general functions: (1) "it restricts payments to insiders to induce those insiders to remain with the debtor's business unless certain specified conditions are satisfied;" (2) "it limits severance payments to insiders;" and (3) "it limits any transaction outside the ordinary course of business, especially those that benefit officers, managers, and consultants hired after the date of the filing of the petition, unless the transactions are justified by the facts and circumstances of the case." 4 COLLIER ON BANKRUPTCY ¶ 503.17[1] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed.).

> which the transfer is made or the obligation is incurred; or
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> **(ii)** if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;
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> **(2)** a severance payment to an insider of the debtor, unless--
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> **(A)** the payment is part of a program that is generally applicable to all full-time employees; and
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> **(B)** the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or
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> **(3)** other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

11 U.S.C. § 503.

Section 503(c)(1) sets forth a statutory test that all insiders must "pass" before the court may allow such payments to them. Section 503(c)(1) precludes payments under a KERP to insiders of a debtor, unless (1) the payment is essential to the retention of the person because the individual has a "bona fide job offer from another business at the same or greater rate of compensation"; (2) the services provided by the person are essential to the survival of the business; and (3) the amount of the payment is "[no] greater than 10 times the amount of the average bonus given to non-management employees during the same calendar year, or, if no such bonuses were given, it must not be greater than 25 percent of any bonus given to the insider in the prior calendar year." Scott Wolfson & Valerie Jackson, Key Employee Incentive Programs Make "Cents" for Creditors, 31 ABI Journal 21 (2012).

Section 503(c)(2) — dealing with severance payments — specifically prohibits *severance* payments to the debtor's insiders unless the payment meets certain requirements. The payments: (1) must be part of a "program that is generally applicable to all full-time employees;" and (2) cannot exceed "ten times the amount of the mean severance pay given to non-management employees during the calendar year in which the payment is made." In re Robb & Stucky Ltd., LLLP, No. 8:11-bk-02801-CED, 2011 WL 3948805, *4 (Bankr. M.D. Fla. Sept. 7, 2011). If the severance pay arises from an employee's individual employment agreement, and not a generally applicable program in which all employees are covered, the first prong of section 503(c)(2) is not met. If these requirements are not met, the severance payment is prohibited. Id.

Section 503(c)(3) — dealing with other transfers to employees — limits payments made to a debtor's insiders *outside of the ordinary course of business* unless such payments are justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition. "Courts have held that the 'facts and circumstances' language of section 503(c)(3) creates a standard no different than the business judgment standard under section 363(b)." In re Borders Group, Inc., 453 B.R. 459, 473 (Bankr. S.D.N.Y. 2011) (citing In re Dana Corp., 351 B.R. 96 (Bankr. S.D.N.Y. 2006)).

In the case of <u>In re Dana Corp.</u>, 351 B.R. 96 (Bankr. S.D.N.Y. 2006), the court looked closely at the issue of retention payments versus incentive bonuses and the characterization of proposed payments to executives. In this case, the debtors sought court approval to pay their top executives a base salary, annual incentive plan bonuses, "target completion bonuses" and included a senior executive retirement program and a severance package, along with a non-compete agreement. The court was faced with deciding whether the plan was a "Pay to Stay compensation plan" (KERP) subject to the restrictions of section 503(c), or a "Produce Value for Pay" plan, which could be approved under section 363.

In analyzing section 503, the <u>Dana</u> court first focused on the target completion bonus. This bonus was separated into two parts: (1) a fixed bonus with the simple requirement that the executive remain employed with the company at the effective date of the plan of reorganization and (2) a variable bonus conditioned on the total enterprise value of the debtor six months after the effective date of the plan. Despite the debtors' argument that the target completion bonus was an incentive bonus under section 503(c)(3), the court held that "this compensation scheme walks, talks and is a retention bonus." <u>Id</u>. at. 102. In its decision, the court stated, "[w]ithout tying this portion of the bonus to anything other than staying with the company . . ., this Court cannot categorize a bonus of this size and form as an incentive bonus." Id. at 102. The court stated that it was not ruling "that incentivizing plans which may have some components that arguably have a retentive effect, necessarily violate section 503(c)'s requirements." Id. at 103.

Second, the <u>Dana</u> court analyzed the characterization of payments to a senior executive in the event of his termination or resignation from the company. Under the proposed compensation plan, if one of these events occurred, the senior executive would execute an 18 month non-compete agreement and would receive a specified payment for that term and a pro rata payout of the Completion Bonus. The debtors attempted to characterize these amounts as "payments in exchange for non-compete agreements," thereby circumventing the requirements for severance payments under section 503(c)(2). However, the <u>Dana</u> court held that the payments were actually severance payments for the purpose of section 503(c)(2), and that the debtors failed to establish the requirements under section 503(c)(2).

In its decision, the Dana court further determined that BAPCPA "makes it abundantly clear" that the business judgment rule, even if it exists, has no application under sections 503(c)(1) and (c)(2), as the "specific evidentiary standards must be met before a bankruptcy court may authorize payments made to an insider for the purpose of inducing such person to remain with a debtor's business, or payments made on account of severance." Id. at 100.

Courts apply more relaxed standards to incentive plans, as compared to KERP plans, which invoke the stringent requirements of section 503(c)(1). See In re Residential Capital, LLC, 478 B.R. 154, 171 (Bankr. S.D.N.Y. 2012)("When a plan is designed to motivate employees to achieve specified performance goals, it is primarily incentivizing, and thus not subject to section 503(c)(1).").

Interestingly, a recent study by Vidhan K. Goyal of the Hong Kong University of Science and Business at Queen's University in Ontario, "concluded that Chapter 11 plans containing employment incentive programs lead to better results in bankruptcy than reorganization plans that do not contain incentive programs." Key Employee Incentive Programs Make "Cents" for Creditors, 31 ABI Journal at 21 (citing Vidhan K. Goyal and Wei Wang, Provision of Management Incentives in Bankrupt Firms (Aug. 8, 2012)). The study determined that employee incentive programs, unlike retention programs, "significantly improve outcomes for creditors." Id. at 22 (citing Goyal and Wang, at 4). Such a conclusion is thought to stem from the idea that employee incentive programs "tie the ability of an employee to receive a bonus or a benefit to a business goal," while KERP plans pay employees regardless of whether the business fails or succeeds. Id. Therefore, employees under incentive based plans have an *incentive* to work towards the success of the business rather than just being paid for remaining on the job.

VI. WARN ACT

A. Notice Requirements Under the WARN Act

Pursuant to 29 U.S.C.A. §2102, *et seq.*, also known as the Worker Adjustment and Retraining Act (the "WARN Act"), an employer is required to provide written notice to all affected employees of a mass layoff or a plant closing at least 60 days before the layoff or closing occurs. An employer who violates the WARN Act is liable for back pay, lost benefits, civil penalties and attorney's fees. 29 U.S.C. § 2104(a)(1); see also Rowan v. Chicago Hous. Auth., 149 F. Supp. 2d 390, 392 (N.D. Ill. 2001).

The WARN Act was implemented with the primary purpose of assuring the "most rapid possible readjustment and retraining of displaced workers" and to "ease the personal and financial difficulties for workers who must make these transitions." Local Joint Executive Bd. of Culinary/Bartender Trust Fund v. Las Vegas Sands, Inc., 244 F.3d 1152, 1159 (9th Cir. 2001) (citing Economic Dislocation and Worker Adjustment Assistance Act, s. rep. no. 100-62, at 3 (1987)).

WARN Act notices are required under the following circumstances:

Plant Closing Notice required if there is:	**Mass Layoff** Notice required if there is:
1) A Loss of Employment,	1) A Loss of Employment,
2) At a *Single* Site of Employment,	2) At a *Single* Site of Employment,
3) Where: • *50 or more employees* (not including part-time employees)[5] at the single site of employment suffer an employment loss	3) Where: • *50 or more employees* (not including part-time employees), who *constitute at least 1/3 of the employees* at the single site of employment, suffer an employment loss **OR** • *500 or more employees* (not including part-time employees) at the single site of employment suffer an employment loss

Section 2102(b) "contains three exceptions to the notice requirement: the 'faltering company' exception, the 'business circumstances' exception and the 'natural disaster' exception." In re APA Transp. Corp. Consol. Litig., 541 F.3d 233, 240 (3d Cir. 2008). Under these exceptions, an employer is not required to give a WARN Act notice at least 60 days prior to a layoff or mass closing.

With respect to the first exception—the "faltering company" exception— the Act states:

> an employer may order the shutdown of single site of employment before the conclusion of the 60-day period if as of the time that notice would have been required the employer was actively seeking capital or business which, if obtained, would have enabled the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believed that

[5]The Term "part-time employees" is defined under 29 U.S.C. § 2101(a)(8) as "an employee who is employed for an average of fewer than 20 hours per week *or* who has been employed for fewer than 6 of the 12 months preceding the date on which notice is required." (emphasis added).

> the giving the notice required would have precluded the employer from obtaining the needed capital or business.

29 U.S.C. § 2102(b)(1).

To fall within the faltering company exception, an employer must meet four requirements. See Carpenters Dist. Council of New Orleans & Vicinity v. Dillard Dept. Stores, Inc., 15 F.3d 1275, 1281 (5th Cir. 1994). The employer must show that:

> (1) it was actively seeking capital at the time the 60-day notice would have been required, (2) it had a realistic opportunity to obtain the financing sought, (3) the financing would have been sufficient, if obtained, to enable the employer to avoid or postpone the shutdown, and (4) the employer reasonably and in good faith believed that sending the 60-day notice would have precluded it from obtaining the financing.

In re APA Transp. Corp. Consol. Litig., 541 F.3d at, 246-47.

Under the second exception—the "business circumstances" exception—an employer must show that the closing or layoff was "caused by business circumstances that were not reasonably foreseeable as of the time that notice would have been required." 29 U.S.C. § 2102 (b)(2)(A). See Gross v. Hale-Halsell Co., 554 F.3d 870 (10th Cir. 2009). In determining foreseeability, one bankruptcy court, citing to 20 C.F.R. 639(b) wrote:

> (1) An important indicator of a business circumstance that is not reasonably foreseeable is that the circumstance is caused by some sudden, dramatic and unexpected action or condition outside the employer's control. A principal client's sudden and unexpected termination of a major contract with the employer, a strike at a major supplier of the employer, and an unanticipated and dramatic major economic downturn might each be considered a business circumstance that is not reasonably foreseeable. . . .
>
> (2) The test for determining when business circumstances are not reasonably foreseeable focuses on an employer's business judgment. The employer must exercise such commercially reasonable business judgment as would a similarly situated employer is predicting the demands of its particular market . . . .

In re Organogenesis Inc., 316 B.R. 574, 587-588 (Bankr. D.Mass. 2004).

Finally, the third exception—the "natural disaster" exception—is self explanatory in that "[n]o notice … shall be required if the plant closing or mass layoff is due to any form of natural disaster, such as a flood, earthquake, or the drought currently ravaging the farmlands of the United States." 29 U.S.C.A. § 2102 (b)(2)(B). "To qualify for this exception, an employer must be able to demonstrate that its plant closing or mass layoff is a *direct* result of a natural disaster." 20 C.F.R. §639.9(c)(2) (emphasis added). While only plant closings or mass layoffs resulting *directly* from natural disasters will fall under the natural disaster exception, where the plant closing or mass layoff results *indirectly* from a natural disaster, the unforeseeable business circumstance exception described above may be applicable. See, 20 C.F.R. §639.9(c)(4).

B. Is a Trustee Exempt from the WARN Act Notice Requirements?

While there are no Chapter 11 cases that specifically refer to a "trustee exemption" from the WARN Act notice requirement, there are some Chapter 7 cases that do.

For instance, in In re Century City Doctors Hospital, L.L.C., 417 B.R. 801 (Bankr. C.D. Cal. 2009), a Chapter 7 trustee obtained authority to operate Century City Doctors Hospital for a limited period of time for the purpose of transferring patients, shutting down operations and complying with government regulations relating to the disposal of medical waste and hazardous materials. When WARN Act claims were made against the estate because the Chapter 7 Trustee did not give 60-day notice prior to closing the hospital, the court determined that the trustee was a "fiduciary whose sole function in the bankruptcy process [was] to liquidate a failed business for the benefit of the creditors." Id. at 805 (citations omitted), and was *not* an employer under the WARN Act. Thus, the Chapter 7 trustee was not subject to the notice requirements of the WARN Act.

Similarly, in Chauffeurs, Sales Drivers, Warehousemen & Helpers Union Local 572, International Brotherhood Of Teamsters, AFL-CIO v. Weslock Corp., 66 F.3d 241 (9th Cir. 1995), an employer surrendered its manufacturing plants to its secured creditor, and the secured creditor advised the union representative that the plants would be closed. The union sued the secured creditor for violating the WARN Act. The issue before the Ninth Circuit was whether the secured creditor constituted an employer under the WARN Act. In analyzing this issue, the court viewed the secured creditor as a fiduciary, i.e. a trustee, holding that "application of WARN to a 'fiduciary' (i.e., a trustee) . . . is dependent on whether the fiduciary has in fact operated the debtor's assets as a business enterprise in the normal commercial sense." Id. Upon a review of the facts, the court held that no evidence existed that the secured creditor had any involvement in the operations of the debtor and the secured creditor's only control was limited to its financial control designed to preserve its security interest in the plants. Thus, the secured creditor did not constitute an employer under the WARN Act.

While there have been some cases in which a chapter 7 trustee was not subject to the WARN notice requirement, these cases usually rely on the short duration of the trustee's control over the business or the trustee's simple actions to liquidate the debtor's assets.[6]

C. Liability of Equity Sponsors and Lenders

Owners and lenders involved with failing companies often are concerned with their potential WARN Act liability. See 21 J. Bankr. L. & Prac. 2 Art. 3. Since in many situations the direct employer may be insolvent at the time of the event triggering WARN Act notice, "terminated employees frequently assert WARN Act claims against entities related to the direct employer, including parent companies and lenders, on the theory that such entities are the actual responsible parties under the statute." Id.

In the recent case In re Tweeter OPCO, LLC., 453 B.R. 534 (Bankr. D.Del. 2011), the court had to determine whether the lender/parent company was liable with the direct employer for WARN Act notice purposes. 453 B.R. 534, 541 (Bankr. D. Del. 2011). In making its determination, the bankruptcy court utilized a five-factor test set forth by the Department of Labor which considers:

> (1) common ownership, (2) common directors and/or officers, (3) the *de facto* exercise of control, (4) unity of personnel policies emanating from a common source, and (5) the dependence of operations between the entities.

Id. at 541 (further citation omitted). The court noted that "[t]hese five factors constitute a non-exhaustive list and the fact-finder may consider other evidence of entanglement." Id.

Applying these factors, the court determined that the lender/parent corporation had "substantial indirect ownership interest in the debtor" and financial control over the debtor through its lender relationship and that "[f]inancial control itself is sufficient to

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[6] See Finkler v. Elsinore Shore Assocs., 725 F.Supp. 828 (Bankr. D. N.J. 1989); In re United Healthcare Systems, Inc., 200 F.3d 170 (3d Cir. 1999).

satisfy the common ownership factor." Id. at 542-43. Thus, the parent/lender was found liable with the debtor to provide the WARN Act notice. See also Pearson, 247 F.3d 471, 494 (3d Cir. 2001) ("'financial control' will suffice to satisfy the 'common ownership' prong of the integrated enterprise test, and it is likely that the DOL factors should be interpreted similarly . . . .") (citation omitted).

While the Tweeter decision "seemingly broadens the scope of single-employer liability to include lenders and equity sponsors . . . [t]wo recent decisions from Delaware bankruptcy courts[7]. . . indicate that the single-employer issue remains highly fact-dependent." 21 J. Bankr. L. & Prac. 2 Art. 3.

In In re DHP Holdings II Corp., 447 B.R. 418 (Bankr. D. Del. 2010), the debtors, DHP Holdings II Corp. ("Holdings") and its direct and indirect subsidiaries, were accused by their employees of violating the WARN Act notice requirements. H.I.G. Capital, LLC ("HIG") was an indirect owner of Holdings, owning a seventy percent stake in DHP Acquisition Corp., which owned Holdings, which owned Desa LLC, the parent company of all of the other Debtors. Id. The employees of the Debtors asserted that HIG and the debtors constituted a "single employer" for purposes of the WARN Act. The DHP Holdings court applied the same Department of Labor standards utilized in Tweeter to evaluate whether HIG was a single employer. The court determined that, while HIG and the Debtors had common ownership, and common directors and officers, the remaining three factors indicated that HIG was not a single employer with the debtors.

The DHP Holdings court found that HIG did not exercise *de facto* control over the debtors' termination of the employees because the debtors' chief restructuring officer made the decision to terminate the employees and close the facilities, and there was no evidence that any HIG employee or common director/officer had any knowledge of or controlled that decision. Also, the court found that since HIG and the debtors did not share a human resources officer, negotiated their own employment contracts independent of one another, maintained separate tax identification numbers and filed separate tax returns, the fourth factor—unity of personnel policies emanating from a common source—was not met. Lastly, the court determined that the fifth factor—dependence of

[7] See In re DHP Holdings II Corp., 447 B.R. 418 (Bankr. D. Del. 2010); In Re Consol. Bedding, Inc., 432 B.R. 115, 123 (Bankr. D. Del. 2010).

operations—was not present because HIG was an investment company without any operations other than managing its investments, HIG continued its own operations after the debtors shut down, and HIG maintained separate bank accounts and personnel for auditing, accounting and benefits administration. After evaluating the five factors, the court held that under the circumstances satisfaction of the first two factors alone could not trigger WARN Act liability for HIG. Id.

In the case of In re Consolidated Bedding, Inc., 432 B.R. 115, 118 (Bankr. D. Del. 2010), the former employees of the debtor, Consolidated Bedding, Inc., sought to recover for WARN Act notice violations from the debtor and American Capital Strategies, Ltd. ("American Capital"), the debtor's lead financier and equity holder. The court applied the Department of Labor's factors to assess whether American Capital could be held liable as a "single employer" with the debtor. American Capital conceded that it shared common ownership with the debtor, satisfying the first factor. The court found, however, that there were no common directors or officers, even though American Capital employees occupied seats on the debtor's board of directors, as the employees were not wearing their American Capital "hats" while serving on the debtor's board. The employees asserted that since American Capital was the debtor's primary financier and equity holder, it held *de facto* control over the debtor. The court held that being the primary financier and equity owner was insufficient to support the inference that American Capital had *de facto* control over the debtor to trigger the WARN Act. As for the "unity of personnel" factor, the employees merely asserted that the American Capital was involved in the decision to close the plant. The court found such allegations were more appropriately considered as part of the "*de facto* control" factor, and were insufficient to satisfy the "unity of personnel" prong. The employees did not make any argument with respect to the fifth factor - operational dependency between the entities.

From a review of these factors, the Consolidated Bedding court found that while "American Capital supervised much of the [d]ebtor's activities and American Capital employees occupied seats on the [d]ebtor's board of directors, the [d]ebtor at all times remained [a] separate business entity that did not rely on American Capital for day-to-day operations." Id. at 124. Concluding that the first prong of "common ownership" was the only factor sufficiently met, the Consolidated Bedding court held that American Capital could not be held liable as a "single employer" for purposes of WARN Act notice liability.

In light of DHP Holdings and Consolidated Bedding, "Tweeter does not signal an open invitation to impose WARN Act liability on lenders, equity sponsors, and other parent entities under all circumstances." 21 j. bankr. l. & prac. 2 art. 3. instead, when analyzing whether equity sponsors and lenders are employers for purposes of WARN Act responsibility, courts must look to the specific facts of the case to determine whether such entities should be liable under the WARN Act.

D. WARN Act Notice Not Required for "Forwarded" Employees

The notion of "forwarding employment" refers to situations where there is a sale of a business and, as part of the sale transaction, the seller "fires" the employees who are then immediately "rehired" by the buyer with no real interruption of employment. The law seems pretty clear that in such circumstances there is no WARN Act responsibility on the seller to provide notice, and no liability to the seller for not doing so. "In construing 'employment loss' under WARN, a court must consider whether, as a practical matter, a break in employment actually occurred." Martin v. AMR Services All F.Supp. Corp., 877 F.Supp. 108, 113 (E.D.N.Y. 1995). "Under this provision, the obligation to [provide WARN notice to] employees in the event of a closure or mass layoff skips from seller to buyer, never triggered by the sale." Headrick v. Rockwell Int'l Corp., 24 F.3d 1272, 1280 (10th Cir. 1994).

"As the legislative purpose underlying WARN is to ensure adequate time for employees to adjust to their prospective loss of employment, where employees are transferred almost instantly to other positions, the need to ensure adequate time for retraining or reemployment does not exist and, therefore, WARN is not violated." Martinez v. Caravan Transp., Inc., 253 F.Supp.2d 403, 412 (E.D.N.Y. 2003). "Thus, unless the purchaser refuses to rehire them or lays them off, there is no 'employment loss' and so no duty of advance notice of the 'mass layoff.'" International Oil, Chemical & Atomic Workers, Local 7-517 v. Uno-Ven Co., 170 F.3d 779, 784 (7th Cir. 1999) (further citation omitted).

VI. REJECTION OF LABOR UNION CONTRACTS

Section 1113 of the Bankruptcy Code governs the debtor in possession's assumption or rejection of collective bargaining agreements. 11 U.S.C. § 1113(a). "Section 1113 sets up a procedure that requires the debtor in possession to negotiate with the employees' representative before the court can grant a motion to reject the collective bargaining agreement." In re N. Am. Royalties, Inc., 276 B.R. 587, 590 (Bankr. E.D. Tenn. 2002); 11 U.S.C. § 1113(b).[8]

Once the debtor has fulfilled the requirements of Section 1113(b), the court "shall approve the application for rejection of a collective bargaining agreement," under Section 1113(c), only if the court finds that —

> **(1)** the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1);
> **(2)** the authorized representative of the employees has refused to accept such proposal without good cause; and
> **(3)** the balance of the equities clearly favors rejection of such agreement.

11 U.S.C.A. § 1113.

The standards set forth in section 1113 apply only to the rejection of a collective bargaining agreement. See In re N. Am. Royalties, Inc., 276 B.R. at, 591. Also, if the

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[8] Section 1113(b) states:

> **(b)(1)** Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall—
>
> > **(A)** make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
> >
> > **(B)** provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.
>
> **(2)** During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for in subsection (d)(1), the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.

11 U.S.C.A. § 1113.

debtor fails to properly reject the contract, the collective bargaining agreement is deemed assumed. Adventure Res. Inc. v. Holland, 137 F.3d 786, 798 (4th Cir. 1998) ("The collective bargaining agreement between the UMWA and Adventure was assumed in bankruptcy as the result of the latter's failure to reject it in accordance with § 1113."). Therefore, the debtor in possession or trustee must properly follow the requirements of Section 1113(b) in order for the court to grant approval of the collective bargaining agreement rejection.

VII. CONCLUSION

These issues are some of the employment related concerns arising in Chapter 11 bankruptcy cases. The best "rule of thumb" is that Chapter 11 debtors must operate in accordance with generally applicable laws governing employment. However, because of the unique circumstances of bankruptcy, there are sometimes special rules that are applicable.