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EMPLOYEE ISSUES IN CHAPTER 11

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I. ANTICIPATING AND AVOIDING POTENTIAL WARN ACT LIABILITY

A. WARN Act Liability

1. Overview

After failed initiatives in the 1970s and early 1980s, and spurred by the human and social consequences of the large-scale worker dislocations resulting from the "cataclysmic" loss of manufacturing jobs in the 1980s (particularly in the steel belt),[1] Congress enacted the Worker Adjustment and Retraining Notification Act (codified at 29 U.S.C. §§ 2101–2109, the "WARN Act") on August 4, 1988 (effective on February 4, 1989) to protect workers and their families and communities by requiring "employers" to give 60 calendar days' advance written notice of any "plant closing" or "mass layoff."[2] Implementation is supported by Labor Department regulations found at 20 C.F.R. §§ 639.1 *et seq.*

For purposes of the WARN Act, an "employer" is any business enterprise that employs 100 or more employees (excluding part-time employees),[3] or 100 or more employees (not excluding part-time employees) who work at least 4,000 hours per week in the aggregate (excluding overtime).[4] Courts may conclude that the "employer" in a particular case includes the employer of record and its affiliates, where they comprise a single enterprise.[5] Under certain

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1 *See, generally, Plant Closings, Workers' Rights, and the WARN Act's 20th Anniversary: Hearing Before the S. Comm. on Health, Education, Labor, and Pensions*, 110th Cong. 110-945 (2008).

2 29 U.S.C. § 2102(a). The WARN Act is federal law. Many states have enacted similar laws.

3 A "part-time employee" is a person 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. 29 U.S.C. § 2101(a)(8).

The statute does not define "employee." However, the regulations indicate that workers on temporary layoff or leave who have a reasonable expectation of recall are counted as employees. 20 C.F.R. § 639.3(a). An employee has a "reasonable expectation of recall" when he/she understands, through notification or industry practice, that his/her employment has been temporarily interrupted and that he/she will be recalled to the same or a similar job. *Id.*

4 29 U.S.C. § 2101(a)(1).

5 *See Pearson v. Component Tech. Corp.*, 247 F.3d 471 (3d Cir. 2001).

circumstances, courts may conclude that no obligation to give notice arose because the enterprise was no longer a going concern.[6]

The WARN Act defines a "plant closing" as "the permanent or temporary shutdown of a single site of employment" that "results in an employment loss…during any 30-day period for 50 or more employees excluding any part-time employees."[7] It defines a "mass layoff" as a reduction in force (not from a plant closing) that results in an employment loss at the single site of employment during any 30-day period for at least 500 employees (excluding any part-time employees) or at least 50 employees (excluding any part-time employees) if those employees comprise at least 33 percent of the workforce (again, excluding part-time employees).[8] Multiple closings or layoffs occurring at a single site of employment within a 90-day period will be aggregated for purposes of determining whether the applicable minimum is met (*i.e.*, even though each group taken alone would not), unless the employer "demonstrates that the employment losses are the result of separate and distinct actions and causes and are not an attempt by the employer to evade the requirements of" the law.[9]

An "employment loss" is a reduction in hours of more than 50 percent during each month of any 6-month period, a layoff exceeding 6 months, or a termination (other than for cause, voluntary departure, or retirement),[10] unless the closing or layoff is the result of a relocation or consolidation of all or part of the employer's business and the employer had offered to transfer the employee to a different site of employment with no more than a 6-month break in

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6 *Walsh v. Diamond (In re Century City Doctors Hospital, LLC)*, BAP No. CC-09-1235-MkJaD, 2010 WL 6452903, at *9 (9th Cir. BAP 2010).

7 *Id.* at § 2101(a)(2).

8 *Id.* at § 2101(a)(3).

9 *Id.* at § 2102(d).

10 *Id.* at § 2101(a)(6).

employment (and either the employee accepts within 30 days or the new site of employment is within a reasonable commuting distance).[11]

Once triggered, the 60-day notice must be given to the affected workers or their representatives (*e.g.*, labor unions), the State dislocated workers unit, and the appropriate unit of local government.[12]

Failure to give the required notice of a plant closing or mass layoff results in the employer's liability to each employee who suffers an employment loss, for (a) back pay for each day of violation (at either the employee's final regular rate or his/her average regular rate during the last 3 years, whichever is higher) net of any wages, any other voluntary and unconditional payments, and any payments to a third party for the benefit of the employee (such as health benefit premiums), to the extent paid by the employer for that violation period, plus (b) benefits under any employee benefit plan. The maximum period of violation is 60 days, but not more than half the number of days of the aggrieved employee's employment.[13] Violation also results in a civil penalty payable to the local government of up to $500 per day, unless the employer pays the amounts owed to affected employees within three weeks of the employment loss.[14]

Liability may be reduced, in the court's discretion, if the employer proves that its act or omission was in good faith and that the employer reasonably believed it was not violating the statute.[15]

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[11] *Id.* at § 2101(b)(2).
[12] *Id.* at § 2102(a).
[13] *Id.* at § 2104(a).
[14] *Id.* at § 2104(a)(3).
[15] *Id.* at § 2104(a)(4).

2. Statutory Exceptions to Liability

The WARN Act itself provides for reduction of liability in certain circumstances. The primary exceptions are where the company is "faltering" or where there is an "unforeseeable business circumstance."[16] Notwithstanding any such statutory defense to giving WARN Act notice, however, the employer must give "as much notice as practicable" and a "brief statement of the basis for reducing the notification period."[17]

a) Faltering Company Exception

An employer may provide less than 60 days' notice of a plant closing (but not a mass layoff) if, "as of the time the notice would have been required the employer was actively seeking capital or business" which would have enabled the employer to avoid or delay the shutdown.[18] However, the employer must have believed—reasonably, and in good faith—that giving the required notice would have precluded the employer from obtaining the needed capital or business.[19]

The faltering company exception was intended to be narrowly construed by courts.[20] Thus, for example, in *In re APA Transp. Corp. Consol. Litig.*, a single exchange with a lender that is not a formal request for financing was insufficient to demonstrate that a company was

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[16] In addition, no notice is necessary if the plant closing or mass layoff is caused by a natural disaster. 29 U.S.C. § 2102(b)(2)(B). The WARN Act also provides that it does not apply to plant closings or mass layoffs involving a temporary facility, or if the closing or layoff is due to completion of a project or undertaking for which the affected employees were hired with the understanding that their employment was limited to its duration, or the closing or layoff constitutes a strike or lockout not intended to evade the requirements of the statute. *Id.* at § 2103(1).

[17] *Id.* at § 2102(b)(3).

[18] *Id.* at § 2102(b)(1); 20 C.F.R. § 639.9(a) ("The exception…applies to plant closings but not to mass layoffs").

[19] 29 U.S.C. § 2102(b)(1); 20 C.F.R. § 639.9(a).

[20] *See* 20 C.F.R. § 639.9(a) ("The exception…should be narrowly construed."); 54 Fed. Reg. 16,061 (1996) ("The language in § 639.9(a), discussion [*sic*] the faltering company exception has been revised to indicate that exception should be narrowly construed."); *In re Jevic Holding Corp.*, 496 B.R. 151, 163 n.36 (Bankr. D. Del. 2013).

"actively seeking" capital.[21] Further, the employer there had not taken any immediate steps to secure an extension of its expiring loan facility or any additional financing.[22]

In addition, the exception is limited to securing new business or seeking capital through loans, bonds or stocks or "other methods of internally generated financing," and does not extend to a sale of the company's assets.[23]

b) Unforeseeable Business Circumstance Exception

An employer may provide less than 60 days' notice "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."[24] To qualify, the employer must show that its business circumstances (i) were "unforeseeable," and (ii) actually caused the plant closing or mass layoff.[25]

The Labor Department's regulations explain that "[a]n 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."[26] The regulations provide several examples: a principal client's sudden and unexpected termination of a major contract, a strike at a major supplier, an unanticipated and dramatic economic downturn,

[21] 541 F.3d 233 (3d Cir. 2008), *as amended* (Oct. 27, 2008).

[22] *Id*.

[23] 20 C.F.R. § 639.9(a). *See also, e.g., Local 397, Int'l Union of Electronic, Elec., Salaried, Mach. & Furniture Workers, AFL-CIO v. Midwest Fasteners, Inc.*, 763 F. Supp. 78, 80 (D.N.J. 1990) (negotiating sale of company does not qualify as "actively seeking capital"); *In re AE Liquidation, Inc.*, 522 B.R. at 68 (Bankr. D. Del. 2014) ("Case law makes clear that a sale of the business does not meet [the actively seeking capital] definition."), *aff'd*, 556 B.R. 609 (D. Del. 2016).

[24] 29 U.S.C. § 2102(b)(2)(A). *See also* 20 C.F.R. § 639.9(b).

[25] *In re AE Liquidation*, 556 B.R. 609, 616-17 (D. Del. 2016) (citing *Calloway Caraco Pharm. Labs., Ltd.*, 800 F.3d 244, 251 (6th Cir. 2015)).

[26] 20 C.F.R. § 639.9(b)(1). *See also Burnsides v. MJ Optical, Inc.*, 128 F.3d 700, 703 (8th Cir. 1997) ("An unforeseeable business circumstance is 'a sudden, dramatic, and unexpected event outside the employer's control.'") (quoting *Loehrer v. McDonnell Douglas Corp.*, 98 F.3d 1056, 1061 (8th Cir.1996)).

and a government-ordered closing without prior notice.[27] Notwithstanding these examples, whether circumstances were reasonably foreseeable is to be assessed on a case by case basis and involves a highly factual inquiry.[28]

In determining whether business circumstances were reasonably foreseeable, courts "consider the facts and circumstances that led to the closing in light of the history of the business and of the industry in which that business operated."[29] Moreover, courts "do not consider the employer's own subjective assessment, but rather whether it had exercised 'such commercially reasonable business judgment as would a similarly situated employer.'"[30] Within that context, the determining factor is "whether the triggering event was probable, not merely possible."[31]

Unlike the faltering company exception, the Labor Department's regulations do not require that this exception be narrowly construed.[32] Courts are to evaluate the exception objectively, as of the time the decisions were made, and not with the benefit of hindsight.[33]

Each of the following has been found to qualify as an unforeseeable business circumstance: the failure of a sale of the company;[34] failure to obtain renewal of a forbearance

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[27] *Id.*

[28] *See McDonnell Douglas*, 98 F.3d at 1060.

[29] *See, e.g., Hotel Employees & Rest. Employees Int'l Union Local 54 v. Elsinore Shore Assocs.*, 173 F.3d 175, 186 (3d Cir. 1999).

[30] *Pena v. Am. Meat Packing Corp.*, 362 F.3d 418, 421 (7th Cir. 2004) (citing 20 C.F.R. § 639.9(b)(2), and reversing summary judgment for employer and finding a genuine issue of material fact as to the reasonable foreseeability of a suspension of production and distribution mandated by the USDA due to noncompliance issues). *See also In re AE Liquidation*, 556 B.R. at 618-19; *MJ Optical*, 128 F.3d at 703.

[31] *In re AE Liquidation, Inc.*, 556 B.R. at 619 (citing *Jevic*, 496 BR at 160-61). *See also Roquet v. Arthur Andersen LLP*, 398 F.3d 585, 589 (7th Cir. 2005).

[32] *See* 54 Fed. Reg. 16,061 (1996) ("The Department has reviewed the legislative history and agrees it may not [be] appropriate to say that the unforeseeable business circumstances…exception[] should be narrowly construed."). *See also In re Jevic*, 496 B.R. at 163 n.36.

[33] *In re AE Liquidation, Inc.*, 556 B.R. at 618 (citing *Jevic*, 496 BR at 161, and *Watson v. Mich. Indus. Holdings, Inc.*, 311 F.3d 760, 764 (6th Cir. 2002) ("a reviewing court must be careful to avoid analysis by hindsight…")).

agreement after multiple prior renewals in similar situations;[35] the 2008 economic crisis;[36] massive revenue losses occurring after a firm was indicted by the Department of Justice, even though the employer knew of the investigation and was in talks with the DOJ 60 days prior to the terminations;[37] unexpected non-payment for items already shipped;[38] failure to obtain renewal of a casino license despite never failing before;[39] the government's cancellation of a contract for military planes;[40] and the sudden closure of a uranium processing plant by the Nuclear Regulatory Committee due to a nitrogen dioxide leak.[41] However, the following were found not to qualify as unforeseeable business circumstances: product seizures after the FDA had given the employer six months to solve significant product problems;[42] and bank refusal to rewrite a line of credit, where the company also faced other factors including increased cost of materials and a depressed market.[43]

3. Liquidating Fiduciary Exception to Liability

In addition to the limited exceptions provided in the WARN Act, bankruptcy case law has provided another exception. Unlike the statutory defenses discussed above, the "liquidating

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[34] *In re AE Liquidation, Inc.*, 556 B.R. at 619; *see also MJ Optical, Inc.*, 128 F.3d at 703.
[35] *In re Jevic*, 496 BR at 162-63.
[36] *United Steel Workers of Am. Local 2660 v. U.S. Steel Corp.*, 683 F.3d 882 (8th Cir. 2012).
[37] *Roquet*, 398 F.3d 585 (7th Cir. 2005).
[38] *Watson*, 311 F.3d at 165-66.
[39] *Elsinore Shore Assocs.*, 173 F.3d at 186.
[40] *McDonnell Douglas Corp.*, 98 F.3d at 1061-63.
[41] *Bradley v. Sequoyah Fuels Corp.*, 847 F. Supp. 863, 863 (E.D. Okla. 1994).
[42] *Caraco Pharm. Labs.*, 800 F.3d 244 (6th Cir. 2015).
[43] *Childress v. Darby Lumber, Inc.*, 357 F.3d 1000 (9th Cir. 2004).

fiduciary" exception eliminates WARN Act notice obligations entirely, instead of just reducing them.[44]

Labor Department commentary on the WARN Act explains that where a fiduciary "continue[s] to operate the business for the benefit of creditors, the fiduciary would succeed to the WARN obligations of the employers precisely because the fiduciary continues the business in operation."[45] The "liquidating fiduciary" exception applies in the converse situation: "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."[46] The exception turns on the notion that a company that ceases to be a going concern no longer qualifies as a "business enterprise"—and thus, an "employer"—and so is not prohibited under the WARN Act from ordering a plant closing or mass layoff without 60 days' advance written notice to employees.[47] Whether a company is, or is no longer, a business enterprise is not necessarily as straightforward as one might expect.

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[44] *See, e.g., Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (In re United Healthcare Sys., Inc.)*, 200 F.3d 170, 177-79 (3d Cir. 1999); *Chauffeurs, Sales Drivers, Warehousemen Helpers Union Local 572 v. Weslock Corp.*, 66 F.3d 241, 244 (9th Cir. 1995) (stating that "WARN's obligations…can apply…only where the [secured] creditor operates the debtor's asset as a 'business enterprise' in the 'normal commercial sense'"); *In re Century City*, 2010 WL 6452903, at *6-7 (affirming motion to dismiss WARN Act claim against liquidating fiduciary); *Thielmann v. MF Global Holdings Ltd. (In re MF Global Holdings Ltd.)*, 481 B.R. 268, 280-81 (Bankr. S.D.N.Y. 2012); *Barnett v. Jamesway Corp. (In re Jamesway Corp.)*, 235 B.R. 329, 343 (Bankr. S.D.N.Y. 1999); *Barnett v. Jamesway Corp. (In re Jamesway Corp.)*, 1997 WL 327105, *12 (Bankr. S.D.N.Y. 1997) (stating that "liquidating fiduciaries need not provide notice to terminated employees under the WARN Act").

[45] 54 Fed. Reg. 16,042 (1989).

[46] *Id.* at 16,045.

[47] *See In re Century City,* 2010 WL 6452903, at *9 (stating that the "crucial question is whether the WARN Act defendant at the time of the terminations is responsible for operating the business as a going concern") (internal quotations omitted).

In *In re United Healthcare*, a hospital surrendered its "certificates of need" (required under applicable state law to operate as a hospital) and ceased operating as a hospital on the day before it gave its employees the WARN Act notice and filed its chapter 11 petition.[48] Employees were instructed to continue reporting for work, but instead of performing their regular duties, they cleaned, took inventory and prepared assets for sale until terminated after 16 days (at the insistence of the official committee of unsecured creditors).[49] The debtor, bankruptcy court and district court all believed the employees were entitled to back pay under the WARN Act. On appeal by the committee, however, the Third Circuit excused the debtor's failure to give the full 60 days' notice because only fiduciaries engaged in business qualify as "employers" obligated to provide the notice.[50]

To "engage in business," a company must "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."[51] This is hardly a bright line, and in practical terms there are likely to be degrees of engagement in business that a court will have to consider. Thus,

> [w]hether 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.[52]

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48 200 F.3d 170, 173 (3d Cir. 1999).

49 *Id.*

50 *Id.* at 177 (finding the debtor acted as a business liquidating its affairs while in bankruptcy and not as a business operating a going concern).

51 20 C.F.R. § 639.3(a)(1)(ii).

52 *In re United Healthcare*, 200 F.3d at 178.

United Healthcare may be an example of the easy case—it ceased to be a business enterprise when it "surrendered its certificates of need, stopped treating patients, and entered bankruptcy to liquidate its assets."[53] It did not matter that the hospital had filed for chapter 11 instead of chapter 7. In contrast, in *In re Jamesway*,[54] the New York bankruptcy court found that a company that had failed to sell itself prepetition and for which liquidation was the only remaining alternative for generating a return to creditors, was nonetheless still an operating business when it decided to terminate its employees, identified the employees who would lose their jobs, determined the termination schedule, and commenced terminations six days before filing a bankruptcy case to liquidate. As a result, the employees were "affected employees" entitled to WARN protection,[55] the company could not use the "liquidating fiduciary" exception, and the WARN Act was violated.[56] The bankruptcy court held that the chapter 7 filing six days later did not eliminate the company's WARN Act obligations. It remains to be seen whether a company whose only remaining operations are the conduct of going-out-of-business sales would be found to be "engaged in business" for purposes of determining WARN Act liability.

The mere fact of having filed a bankruptcy case, or even a chapter 7 liquidation, is not the key to the liquidating fiduciary exception. In *In re Dewey & LeBoeuf LLP*, the bankruptcy court pointed out that the petition date is not determinative in all cases of whether an employer qualifies for the exception, citing *United Healthcare* as an example of when a debtor terminated

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53 *Id.* at 176-177.

54 235 B.R. 329, 337-38 (Bankr. S.D.N.Y. 1999).

55 "[T]he term 'affected employees' means employees who may reasonably be expected to experience an employment loss as a consequence of a proposed plant closing or mass layoff by their employer." 29 U.S.C. § 2101.

56 *In re Jamesway*, 235 B.R. at 344-346.

its employees prepetition but after it had clearly demonstrated an intent to liquidate.[57] While not addressing the issue directly, the *Dewey* court suggested that if a debtor had no choice but to liquidate when layoffs occurred, it might be a liquidating fiduciary even during the prepetition period.[58]

4. Liability of Related Entities

Entities related to the employer of record can be found liable for WARN Act violations together with the employer of record. Department of Labor regulations provide that "subsidiaries which are wholly or partially owned by a parent company are treated as separate employers or as a part of the parent…depending upon the degree of their independence from the parent."[59] Relevant factors include the following five set out in the regulations: (i) common ownership, (ii) common directors and/or officers, (iii) de facto control, (iv) unity of personnel policies emanating from a common source, and (v) dependency of operations.[60]

These factors have been adopted and applied by the Second Circuit and Third Circuit (and lower courts in other jurisdictions) to determine when related entities constitute a "single employer" for WARN Act purposes.[61]

No single factor is determinative, and not all factors need to be present. However, the presence of only common ownership and common management will not typically establish

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57 *Conn v. Dewey & LeBoeuf LLP (In re Dewey & LeBoeuf LLP)*, 487 B.R. 169, 175 (Bankr. S.D.N.Y. 2013).

58 *Id.* at 175-76.

59 20 C.F.R. § 639.3(a)(2).

60 *Id*.

61 *See, e.g.*, *Czyzewski v. Sun Capital Partners, Inc. (In re Jevic Holding Corp.)*, *In re Jevic Holding Corp.*, 526 B.R. 547 (D. Del. 2014), *aff'd*, 656 F. App'x 617 (3d Cir. 2016); *Pearson*, 247 F.3d 471 (3d Cir. 2001); *Guippone v. BH S&B Holdings LLC*, 737 F.3d 221, 226 (2d Cir. 2013); *Blough v. Voisard Mfg.*, 2015 U.S. Dist. LEXIS 9267 (N.D. Ohio, Jan. 27, 2015).

liability.[62] Instead, "[t]he last three factors—de facto exercise of control, unity of personnel policies emanating from a common source, and dependency of operations—are often the determinative factors."[63] The inquiry is focused on the degree of control exercised by the related entity over the employment decisions of the nominal employer,[64] so a "particularly striking" showing of *de facto* control can warrant liability even in the absence of the other factors.[65]

In *Guippone*, the Second Circuit adopted the five factors set out in the Labor Department regulations and found that a parent entity had "single employer" liability with its subsidiary.[66] In that case, a group of hedge funds had purchased the assets and business of retail chain Steve & Barry's, structuring its acquisition through a parent holding company ("Parent") and a subsidiary operating LLC ("Opco"). Not long afterwards, Parent decided to liquidate Opco, which was facing a liquidity crisis. Parent's board replaced Opco's senior management with a consulting firm to manage an orderly liquidation, and approved the consulting firm's recommended plan for immediate mass layoffs in connection with a bankruptcy filing. WARN Act notices were sent beginning two days before Opco filed for bankruptcy.

Guippone, a terminated employee, filed a class action against both Opco and Parent. The District Court granted Parent's motion for summary judgment, finding no abuse of corporate formalities or of Parent's ordinary powers of ownership where Opco had been formed under

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[62] *Pearson*, 247 F.3d at 494.

[63] *Hampton v. Navigation Capital Partners, Inc.*, 2014 WL 4100418, at *3 (D. Del. Aug. 19, 2014) (citing *In re APA Transport*, 541 F.3d 233 (3d Cir. 2008)).

[64] WARN Act liability may also extend to creditors of the employer of record. "[W]hen a lender becomes so entangled with its borrower that it has assumed responsibility for the overall management of the borrower's business…the degree of control necessary to support employer responsibility under WARN [will] be achieved." *Guippone v. BH S&B Holdings LLC*, 737 F.3d 221, 225 (2d Cir. 2013) (citing *Coppola v. Bear Stearns & Co.*, 499 F.3d 144, 150 (2d Cir. 2007)).

[65] *Pearson*, 247 F.3d at 504.

[66] 737 F.3d 221 (2d Cir. 2013).

Delaware law (which allows day-to-day management of an LLC to be vested in its members or a manager appointed by them). On appeal, however, the Second Circuit found there was a question of fact for trial on Parent's WARN Act liability as a "single employer" with Opco. In doing so, the Second Circuit found (among other things) that Opco did not have its own board of directors or managers, but was instead managed by Parent, its sole member and manager. The Court also found that Parent's control over Opco (with which it shared some officers) extended to the selection and engagement of Opco's CFO, negotiation of Opco's financing, and participation in the decision to terminate Opco's employees. Observing that "[a]uthorizing layoffs is not just a prerogative of ownership—it's a function of being an employer," the Court posed the central question for the factfinder as "whether the parent has specifically directed the allegedly illegal employment practice that forms the basis for the litigation."[67]

Applying the Labor Department's five-factor analysis to very different facts in *In re Jevic*, the District Court in Delaware reached the opposite conclusion.[68] There, private equity fund Sun Capital had purchased trucking company Jevic Transportation, Inc., which it managed under contract.[69] Although Sun Capital had supported Jevic for some time (guaranteeing debt and negotiating certain forbearances), Sun Capital eventually decided to stop investing in Jevic. After efforts to sell the company failed, its board authorized bankruptcy and Jevic terminated its employees the day before filing its petition.

Terminated employees filed a class action against both Jevic and Sun Capital (under the WARN Act and its New Jersey counterpart). The bankruptcy court granted Sun Capital's motion for summary judgment, holding that Sun Capital was not a "single employer" with Jevic for

[67] 737 F.3d at 227.
[68] 526 B.R. 547 (D. Del. 2014).
[69] *Id.* at *2.

WARN Act purposes.[70] On appeal, the District Court affirmed, applying the Third Circuit's test for "single employer" liability.[71]

Asking whether Sun Capital "specifically directed the allegedly illegal employment practice," the District Court concluded that Sun Capital had not exercised such *de facto* control. In doing so, the Court rejected the argument that Sun Capital's decision to stop investing in Jevic caused the plant closing, and that Sun Capital controlled Jevic because it had two representatives on the three-member board. Instead, the Court found that Jevic itself was responsible for the shut down and for terminating its employees. Focusing on "centralized hiring and firing, payment of wages, and personnel and benefits recordkeeping," the District Court also did not find sufficient evidence of a unity of personnel policies because Sun Capital did not directly hire or fire Jevic employees, pay their salaries, or share their personnel records.[72] Finally, the District Court did not find sufficient day-to-day involvement in Jevic's operations to conclude there was a dependency of operations. To the contrary, the two entities did not share administrative services, equipment, or facilities, and maintained separate bank accounts, financial statements, and books and records. The Court noted that this factor is not satisfied by a parent exercising its "ordinary powers of ownership," or lending funds, or providing management services under contract (including with respect to the bankruptcy) as an "independent contractor."[73] Instead,

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[70] In a separate decision, the bankruptcy court held there was no liability under the New Jersey statute because the "unforeseeable circumstances" exception (discussed below) applied. *Czyzewski v. Jevic Transp. Inc. (In re Jevic Holding Corp.)*, 496 B.R. 151 (Bankr. D. Del. 2013).

[71] 526 B.R. at 552 (citing *Pearson*, 247 F.3d 471 (3d Cir. 2001)).

[72] *Id.* at 554.

[73] *Id.* at 555-56. It is an interesting question whether the bankruptcy court or the district court would have held differently if they had heard the arguments made in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129 (1st Cir. 2013), *cert. denied*, 134 S. Ct. 1492 (2014) (regarding unfunded pension obligations), discussed below, regarding the closeness with which Sun Capital typically controlled its portfolio companies.

this factor requires that "plaintiffs…establish the existence of what was known at common law as a 'master-servant' agency relationship."[74]

As these cases demonstrate, to the extent a related entity assumes *de facto* control over employment decisions (and perhaps regardless of whether it goes beyond exercising the "ordinary powers of ownership"), that related entity may be viewed as bearing responsibility—*i.e.*, potential "single employer" WARN Act liability—to those employees for those decisions. These cases instruct that in order to avoid the imputation of a subsidiary's WARN Act liability, or creating a question of fact for trial, such entities should take care not to exercise direct control, and to implement and respect the formalities of corporate governance, including the maintenance of an independent board and separate officers that exercise independent decision-making over employment issues.

5. Liability of Buyer

Where a plant closing or mass layoff occurs in connection with the sale of all or part of a business, either the seller or the buyer bears the obligation to provide the WARN Act notice, depending on whether the closing or layoff occurs before or after the effective date of the sale.

The WARN Act provides that the seller is responsible for providing the notice for plant closings and mass layoffs that occur on or before the effective date of the sale, and the buyer is responsible for providing the notice for plant closings and mass layoffs that occur after the effective date of the sale.[75] Consistent with these provisions, the statute also provides that "any person who is an employee of the seller (other than a part-time employee) as of the effective date

[74] *Id.*

[75] 29 U.S.C. § 2101(b)(1); 20 C.F.R. § 639.4(c).

of the sale shall be considered an employee of the purchaser immediately after the effective date of the sale."[76]

Where a buyer intends to carry out a plant closing or layoff of its employees within 60 days after the sale (*i.e.*, the notice would be required before the effective date of the sale), the Labor Department's regulations make it clear that the seller may give the notice as agent for the buyer but it is still the buyer that bears the statutory notice obligation.[77] Where the seller is terminating its employees on or before the effective date of the sale (for instance, in an asset purchase, as opposed to a stock purchase), some courts have held that the seller is not responsible for giving the WARN notice if the buyer rehires enough of the employees.[78]

Because the buyer will be responsible for providing the required WARN notice regarding a plant closing or mass layoff that occurs after the effective date of the sale, the buyer should address such employee-related issues in the purchase and sale agreement and either provide for the seller to terminate the employees before the effective date of the sale, or else plan to provide the required notice.

B. Treatment of WARN Act Claims in Bankruptcy

In the bankruptcy context, WARN Act claims may be treated as either prepetition claims (unsecured, but entitled to employee wage/benefits priority) or as postpetition administrative

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76 29 U.S.C. § 2101(b)(1).

77 *See* 20 C.F.R. § 639.4(c)(1).

78 *See Int'l Union, Oil, Chem. & Atomic Workers, Local 7-517 v. The Uno-Ven Co.*, 170 F.3d 779 (7th Cir. 1999) (actual termination by seller did not count as a WARN event when the workers were given the opportunity to apply for employment with buyer and many of them were rehired); *Wiltz v. M/G Transp. Svcs., Inc.*, 128 F.3d 957 (6th Cir. 1997); *Headrick v. Rockwell Int'l Corp.*, 24 F.3d 1272 (10th Cir. 1994); *accord Rifkin v. McDonnell Douglas Corp.*, 78 F.3d 1277, 1282-83 (8th Cir. 1996) (after a mass layoff, the court found no termination where laid off employees were rehired by purchaser; actuality of termination controlled and not expectation of employees); *Wilson v. Airtherm Prod., Inc.*, 436 F.3d 906, 912 (8th Cir. 2006) (noting that "it is presumed that a sale of a business as a going concern involves the hiring of the seller's employees unless something indicates otherwise").

expenses (payable in full in cash, either entirely or at least partially), depending on when the plant closing or mass layoff occurred, whether WARN Act damages are deemed to be a form of severance pay, and what treatment is accorded to postpetition severance claims. From the debtor's perspective, if the claims are found to be administrative expenses and the aggregate liability is high, the debtor could be rendered administratively insolvent.[79]

1. Administrative Expense Treatment

Administrative expense treatment for WARN Act claims arises, if at all, under section 503(b)(1)(A) of the Bankruptcy Code, which provides in relevant part as follows:

> (b) ...there shall be allowed administrative expenses... including—
> (1)(A) the actual, necessary costs and expenses of preserving the estate including...
> (i) wages, salaries, and commissions for services rendered after the commencement of the case; and
>
> (ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered…[80]

Subsection (ii) was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Legislative history does not illuminate Congress' intent in adding subsection (ii).

Interpreting the amended statute, the Delaware bankruptcy court in *In re Powermate Holding Corp.* explained: "the time to which the back pay is attributable…is when the rights or claims vest or accrue."[81] The court further concluded that a claimant's WARN Act rights vest on

[79] Of course, to the extent that a co-employer that is not a title 11 debtor bears WARN Act liability, claims against that entity would not be subject to treatment (or discharge) in bankruptcy.

[80] 11 U.S.C. § 503(b)(1)(A).

[81] 394 B.R. 765, 774-75 (Bankr. D. Del. 2008).

the termination date because "the purpose of WARN is to provide a statutory form of severance pay" in lieu of notice.[82] In the Third Circuit, to the extent postpetition severance pay is characterized as payment in lieu of notice (rather than payment at termination based on length of employment), the entire amount is accorded administrative expense treatment.[83] Moreover, "WARN Act claims cannot be divided by the petition date, they are either completely administrative expenses (if the claims vest postpetition) or wage priority claims (if the claims vest prepetition).[84]

Courts in other jurisdictions have concluded similarly.[85] In one case, however, the bankruptcy court in Virginia found that "*Powermate*'s focus on vesting cannot be squared" with the portion of section 503(b)(1)(A)(ii) that provides for an administrative expense "without regard to the time of the occurrence of unlawful conduct on which such award is based."[86]

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82 *Id.* at 776 (citing *Oil, Chemical & Atomic Workers, AFL-CIP-CLC v. Hanlin Group, Inc. (In re Hanlin Group, Inc.)*, 176 B.R. 329 (Bankr. D.N.J. 1995)).

83 *See In re Powermate*, 394 B.R. at 775; *In re Hechinger Inv. Co.*, 298 F.3d 219, 227 (3d Cir. 2002) ("pay at termination in lieu of notice is allowed administrative expense priority because the payments are made in consideration of quick departure from employment after the petition date"). Severance pay at termination based on length of employment receives administrative expense treatment only to the extent of the postpetition employment. *See In re Hechinger*, 298 F.3d at 227; *In re Roth American, Inc.*, 975 F.2d 949, 957-58 (3d Cir. 1992); *In re Public Ledger*, 161 F.2d 762, 774 (3d Cir. 1947).

84 *In re Powermate*, 394 B.R. at n.67. Courts considering the pre-BAPCPA version of section 503(b)(1)(A) consistently held that WARN Act damages for prepetition terminations did not receive administrative expense priority. *See, e.g., Int'l Bhd. of Teamsters, AFL-CIO v. Kitty Hawk Int'l, Inc. (In re Kitty Hawk, Inc.)*, 255 B.R. 428, 439 (Bankr.N.D. Tex. 2000); *In re Riker Indus., Inc.*, 151 B.R. 823, 827 (Bankr. N.D. Ohio 1993); *In re Cargo, Inc.*, 138 B.R. 923, 927 (Bankr. N.D. Iowa 1992). Conversely, WARN Act damages for postpetition terminations received administrative expense priority. *See, e.g., In re Hanlin Group, Inc.*, 176 B.R. 329, 333 (Bankr. D.N.J. 1995).

85 *See, e.g., In Re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008) (employees terminated without notice five days before petition date were not entitled to administrative expense treatment for claims that did not arise from time worked postpetition); *In re Calumet Photographic, Inc.*, 2016 WL 3035468 (Bankr. N.D. Ill. May 19, 2016) (no portion of WARN Act claims of employees terminated prepetition enjoy administrative expense status, as the Seventh Circuit has held that administrative expense claims are meant to reimburse the actual, necessary costs incurred over the course of the bankruptcy to preserve or enhance the value of the bankruptcy estate).

86 *James v. Truland Group, Inc. (In re Truland Group, Inc.)*, 520 B.R. 197, 203 (Bankr. E.D. Va. 2014).

Accordingly, and without further elaboration on the portion of the same subsection specifying "wages and benefits awarded…as back pay attributable to any period of time occurring after commencement of the case," the Virginia bankruptcy court found that a prepetition layoff can give rise to an administrative expense.[87] As a practical matter, it is hard to conceive of a prepetition closing or layoff that would result in back pay attributable to a postpetition period. *In re Truland Group* has not been followed or cited positively by any courts so far, and was rejected in *In re Calumet*.[88]

2. Priority Unsecured Treatment

Although prepetition WARN Act claims do not receive administrative expense treatment in a bankruptcy case, they may be treated with priority under sections 507(a)(4) and (a)(5) of the Bankruptcy Code.[89] Courts have consistently held that WARN Act damages claims of employees terminated prepetition are in "the nature of wages" entitled to priority status under section 507(a)(4).[90] Moreover, "the Code's fairness to employees is met in two ways: (1) If they were not employed on or after the filing date, they are given only a priority over other unsecured creditors for up to $10,950, earned within the previous six months, and a general unsecured claim for other WARN Act damages in excess of the $10,950 cap; and (2) if they were employed post-petition, they could have an administrative expense for the post-petition period, plus the additional WARN Act damages."[91]

[87] *Id.* at 201.
[88] *See In re Calumet Photographic*, 2016 WL 3035468.
[89] *See* 11 U.S.C. § 507(a)(4), (a)(5).
[90] *In re Powermate Holding Corp.*, 394 B.R. at 773; *In re Cargo, Inc.*, 138 B.R. 923.
[91] *In re First Magnus Fin. Corp*., 390 B.R. at 679. The current cap under section 507(a)(4) is $12,850.

C. Practical Strategies For Avoiding WARN Act Liability

Aside from being careful to give any required WARN Act notice in a timely manner where possible, or to contractually allocate the responsibility for doing so (as in a purchase and sale agreement), and to implement and observe corporate independence with respect to employment decisions of affiliated entities, there are a few strategies that may be helpful in avoiding WARN Act liability.

1. Planning

Whether or not the company is a going concern when a plant closing or mass layoff occurs (but especially if it is), it would be better to conduct such events (*i.e.*, establish the "termination date") prepetition in order to keep any resulting WARN Act claims from becoming administrative expenses. Where the company is no longer a "business enterprise" and is being liquidated, however, the liquidating fiduciary exception would preclude terminated employees from having WARN Act claims. Beware, however, that the law on the liquidating fiduciary exception is still unclear and, in any event, involves a highly fact-specific inquiry. Companies should not assume that the exception will apply to them simply because they plan on commencing a liquidation case. Courts can be expected to look to see whether the debtor acted in good faith to keep its employees apprised and did not operate the business as a going concern (including postpetition).

2. Payment in Lieu; Waivers and releases

Courts have found there is no WARN Act violation where the employer offered payment in lieu of notice.[92] The paperwork involved in such payment-in-lieu arrangements should

[92] *See, e.g.*, *Bledsoe v. Emery Worldwide Airlines, Inc.*, 635 F.3d 836, 839, 843 (6th Cir. 2011); *Allen v. Sybase, Inc.*, 468 F.3d 642, 651 (10th Cir. 2006).

contain waivers and releases of the WARN Act notice in exchange for severance payments, which have been upheld.[93]

II. DEALING WITH THE PBGC

A. Generally

The Pension Benefit Guaranty Corporation ("PBGC") is the U.S. government agency, created by Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"),[94] which administers the pension plan termination insurance program under Title IV of ERISA. When a (single-employer) defined benefit pension plan terminates without sufficient funds to pay pension benefits, the PBGC succeeds as its trustee and provides guaranteed pension benefits to participants (up to statutory limits) out of the insurance program's assets.[95]

ERISA and the Internal Revenue Code require plan sponsors to make annual minimum funding contributions to their pension plans (in quarterly installments), generally in an amount that will cover accrued benefits for the year and amortize any funding shortfall over the next seven years).[96] These plans generally are also required to participate in ERISA's pension plan termination insurance program, and to fund it through annual premiums and recoveries on the PBGC's post-termination claims (discussed below).

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[93] *See, e.g.*, *Williams v. Phillips Petroleum Co.*, 23 F.3d 930 (5th Cir. 1994) (terminated employees with executed releases were precluded from bringing WARN Act claims); *Int'l Assoc. of Machinists & Aerospace Workers, AFL-CIO v. Compania Mexicana de Aviacion, S.A. de C.V.*, 199 F.3d 796 (5th Cir. 2000 (upholding a waiver that effectively precluded WARN Act claims); *Local Union No. 1992, Int'l B'hood of Elec. Workers v. Okonite Co.*, 189 F.3d 339 (3d Cir. 1999); *Hardy v. Chicago Hous. Auth.*, 189 F. App'x 510, 513 (7th Cir. 2006).

[94] *See* 29 U.S.C. §§ 1301-1461.

[95] *See id.* at §§ 1322, 1342, and 1361.

[96] IRC § 412(m); Rev. Rul 79-237, 1979-2 C.B. 190. The PBGC generally holds debtors to the statutory requirement to continue making minimum funding contributions postpetition prior to plan termination. Where debtors do so, they often seek court approval as minimum funding contributions should be treated like prepetition unsecured claims to the extent based upon prepetition shortfall (*i.e.*, barred from postpetition payment by the automatic stay).

Although ERISA and the Internal Revenue Code grant the PBGC liens under certain circumstances (noted below), the automatic stay under section 362 of the Bankruptcy Code precludes these liens from arising after the commencement of a bankruptcy case. As a result, in bankruptcy the PBGC's claims are most often general unsecured claims, except to the extent that the PBGC is entitled to priority or administrative expense treatment. Also as a result, the PBGC is often one of the largest unsecured creditors in the bankruptcy case and can wield significant influence as such. Often, the PBGC will serve on the creditors' committee. The size of PBGC's claims have the potential to overwhelm other unsecured claims; however, the claims are often challenged by other creditors, as well as debtors.

B. Termination of Employee Benefit Plans

The commencement of a bankruptcy case does not, and need not, terminate a pension plan. If desired, either the debtor must seek a "distress termination" or the PBGC must seek an "involuntary termination." However, debtors may not want to terminate, because of the resulting PBGC claims, and might even prefer to settle with the PBGC in order to avoid an involuntary termination. Similarly, the PBGC may discourage termination of underfunded plans in order to minimize the obligations it would otherwise have to take on.

Where a debtor does seek to terminate a pension plan, it cannot do so by rejecting it as an executory contract under section 365 of the Bankruptcy Code, but may only terminate it in accordance with ERISA.[97] ERISA prohibits the termination of a pension plan by its sponsor in violation of a collective bargaining agreement. As discussed below, section 1113 of the

[97] *In re Philip Svcs.*, 310 B.R. 802 (Bankr. S.D. Tex. 2004); *In re Exco Mfg.*, 50 F.3d 315 (5th Cir. 1995); *Phillips v. Bebber*, 914 F.2d 31 (4th Cir. 1990). Notwithstanding the potential effect on the debtor's estate, a termination proceeding is not necessarily a "core" proceeding for bankruptcy jurisdiction purposes. *See, e.g., In re United Air Lines, Inc.*, 2006 U.S. Dist. LEXIS 4382 (N.D. Ill. Feb. 2, 2006) (finding an involuntary termination proceeding filed by the PBGC to be non-core and thus could not be decided by the bankruptcy court).

Bankruptcy Code provides the exclusive bankruptcy process for rejecting a collective bargaining agreement (or modifying an agreement to permit termination of a pension plan).[98]

Under ERISA's distress termination provisions, a debtor may terminate a pension plan if (a) the plan administrator provides 60 days advance notice to the PBGC and affected parties, of intent to terminate; (b) the plan administrator provides certain information to the PBGC; and (c) the PBGC determines that one of the following "necessary distress criteria" is satisfied: (i) a bankruptcy liquidation, (ii) a bankruptcy reorganization in which the court has determined that pension plan termination is essential to confirmation of a successful plan of reorganization, (iii) the debtor is unable to pay debts when due and to continue in business without pension plan termination, or (iv) the costs of continuing the pension plan have become unreasonably burdensome due solely to a declining workforce.[99]

The PBGC can commence an involuntary termination if either (a) the plan sponsor has not paid its minimum funding contributions; (b) the plan has insufficient funds to pay benefits when due, (c) a distribution has been made to a substantial owner under 29 U.S.C. § 1343(b)(7), or (d) the possible long-term loss to the PBGC can reasonably be expected to increase unreasonably unless the pension plan is terminated.[100]

C. PBGC Claims

In a bankruptcy case, the PBGC typically files several types of claims, for: unfunded benefit liabilities, minimum funding contributions, unpaid termination insurance premiums, and/or plan termination premiums. The PBGC may file some of these as contingent claims and

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[98] By contrast, the PBGC may terminate a pension plan in an involuntary termination notwithstanding any collective bargaining agreement.

[99] 29 U.S.C. § 1341(c).

[100] 29 U.S.C. § 1342(a)(4).

withdraw them later if the contingency (i.e., plan termination) does not occur or a settlement is reached.

1. Unfunded Benefit Liabilities Claims

If a pension plan is (or would be) underfunded at termination, the PBGC will file a claim for the difference between the actuarial present value of the plan's benefit liabilities and the fair market value of the plan's assets. The PBGC has usually asserted that the benefit liabilities should be calculated using discount rates and other assumptions according to applicable PBGC valuation regulations codified at 29 C.F.R. §§ 4044.41-.75. Although courts have in the past applied bankruptcy principles to calculate PBGC claims using interest rate assumptions applicable to determining the present value of a future payment stream (the "prudent investor" standard),[101] more recent decisions have concluded that the PBGC is correct that ERISA and its regulations control the calculation of an unfunded benefit liabilities claim.[102] These later cases view the claim not as one for "a stream of future payments for which the debtor is liable but as the PBGC's present right, granted by statute, to recover an amount determined under the same statute."[103] The PBGC's claim for unfunded benefit liabilities is not a claim for future payments

[101] *See PBGC v. Belfance (In re CSC Indus. Inc.)*, 232 F.3d 505 (6th Cir. 2000); *PBGC v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators of Utah, Inc.)*, 150 F.3d 1293 (10th Cir. 1998); *LTV Corp. v. PBGC (In re Chateaugay Corp.)*, 126 B.R. 165, 175 (Bankr. S.D.N.Y. 1991) ("[C]laims for a series of cash payments in the future should be discounted to present value by a discount factor which when prudently invested would allow the obligations to be med as they became due."), *aff'd*, 130 B.R. 690 (S.D.N.Y. 1990), *vacated*, 17 Empl. Benefits Cas. 1102 (S.D.N.Y. 1993).

[102] *In re Durango Georgia Paper Co.*, No. 02-21669, 2017 WL 221785 (Bankr. S.D. Ga. Jan. 18, 2017); *See also*, *Crawford v. Riley (In re Wolverine, Proctor & Schwartz, LLC)*, 436 B.R. 253, 263 (D. Mass. 2010); *Dugan v. PBGC (In re Rhodes, Inc.)*, 382 B.R. 550, 559-60 (Bankr. N.D. Ga. 2008); *In re Kaiser Aluminum Corp.*, 339 B.R. 91, 95-96 (Bankr. D. Del. 2006); *In re U.S. Airways Group*, 303 B.R. 784 (Bankr. E.D. Va. 2003).

[103] *In re Durango*, 2017 WL 221785, at *3 (citing *In re U.S. Airways*, 303 B.R. at 793).

because "the debtor has no liability for future payments to the beneficiaries; that liability belongs to the PBGC."[104]

In general, the unfunded benefit liability claim is a nonpriority general unsecured claim unless the PBGC establishes that it (or a portion) relates to services rendered postpetition (entitled to administrative expense treatment)[105] or within 180 days before the petition date (entitled to priority treatment, up to the cap in section 507(a)(5) of the Bankruptcy Code).[106]

In addition, upon termination of a pension plan, ERISA gives the PBGC an automatic lien against all of the assets of the entities in the controlled group (discussed below) for the total unfunded benefit liabilities (up to 30% of the collective net worth of the group).[107] ERISA also provides that in a bankruptcy case, the amount secured by the lien is to be treated as a tax.[108] As a result, the PBGC has argued that its unfunded benefit liabilities claim is entitled to priority as a tax under section 503(b)(1)(B) of the Bankruptcy Code. Most recent decisions reject this argument, however, reasoning that the automatic stay imposed by the Bankruptcy Code precludes the PBGC lien (necessary for the tax priority treatment) from arising and/or being perfected postpetition against debtors.[109]

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[104] *In re Rhodes*, 382 B.R. at 560.

[105] In *In re Chateaugay*, the bankruptcy court and district court rejected the PBGC's argument that its entire unfunded benefit liabilities claim was entitled to administrative expense priority as an "actual, necessary cost of preserving the estate," finding instead that the claim arose only from prepetition services. 115 B.R. 760 (Bankr. S.D.N.Y) (proposed decision), *adopted*, 130 B.R. 690 (S.D.N.Y. 1991), *vacated by consent of the parties*, 1993 U.S. Dist. LEXIS 21409 (S.D.N.Y. June 7, 1993).

[106] As noted below, claims for wages, salaries and commissions relating to services rendered in the 180 days before the petition date also receive priority treatment, albeit under section 507(a)(4) of the Bankruptcy Code, but have first application against the same aggregate cap as section 507(a)(5) claims.

[107] 29 U.S.C. § 1368.

[108] 29 U.S.C. § 1368(2).

[109] *See In re CSC*, 232 F.3d at 510; *In re CF&I Fabricators of Utah, Inc.*, 150 F.3d 1293, 1298 (10th Cir. 1998); *In re Bayly Corp.*, 163 F.3d 1205, 1207, 1212 (10th Cir. 1998). It should be noted, however, that the automatic stay generally does not prevent the lien from arising against non-debtor members of

2. Minimum Funding Contribution Claims

Where a debtor has stopped making minimum funding contributions to its pension plan, the PBGC may assert a claim for these payments. Where unpaid minimum funding contributions total more than $1 million, the Internal Revenue Code grants the pension plan a lien (arising automatically, 60 days after the qualifying missed contribution) on all employer property (and controlled group property, up to 30% of the controlled group's net worth) and provides that the secured amount shall be treated as a "tax due and owing to the United States" in bankruptcy cases.[110] Once again, as with tax priority assertions for unfunded benefit liabilities, if the PBGC's lien is triggered postpetition, the lien (and thus, the claim's tax priority status) is precluded by the automatic stay.[111]

Also as with unfunded benefit liabilities claims, the PBGC may argue that the minimum funding contribution claim should receive other priority treatment or as an administrative expense. For instance, like the unfunded benefit liabilities claim, these claims may be entitled to priority status under section 507(a)(5) of the Bankruptcy Code to the extent attributable to the 180 day period before the petition date, subject to the statutory cap.

The PBGC has also asserted that minimum funding contribution claims are entitled to administrative expense treatment under sections 507(a)(2) and 503(b) of the Bankruptcy Code because these costs of maintaining a pension plan are either an ordinary and necessary business expense[112] or the cost of complying with a regulatory scheme.[113] Where plan benefits have

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the controlled group. In addition, the PBGC would be a secured creditor to the extent it has obtained an unavoidable lien prior to the petition date.

[110] IRC § 412(n).

[111] *In re CSC*, 232 F.3d at 510.

[112] *See, e.g.*, *In re Bayly Corp.*, 163 F.3d at 1206.

continued to accrue postpetition, the PBGC may indeed be entitled to administrative expense treatment for minimum funding installments due postpetition to the extent they are attributable to postpetition labor.[114] However, where the liability underlying the plan contributions arose prepetition, courts have rejected the PBGC's arguments.[115]

3. Unpaid Termination Insurance Premiums

The PBGC also typically files a claim for any pension plan termination insurance premiums the debtor has missed. Typically, the PBGC asserts an administrative priority claim for unpaid premiums postpetition plan years and a general unsecured claim for prepetition plan years. Generally, these claims are far smaller and less controversial than the PBGC's claims for unfunded benefit liabilities and minimum funding contributions.

4. Plan Termination Premiums

Under ERISA, as modified by the Deficit Reduction Act of 2005 and the Pension Protection Act of 2006, companies that terminate an underfunded pension plan (in or out of bankruptcy) must pay a plan termination premium of $1,250 per participant per year for three years after the date of termination (or in the case of a termination in bankruptcy, the date of discharge or dismissal).[116]

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[113] *See, e.g.*, CITE (citing *Reading Co. v. Brown*, 391 U.S. 471 (1968); *In re N.P. Mining Co.*, 963 F.2d 1449, 1456 (11th Cir. 1992); *United States v. LTV Corp.*, 944 F.2d 997, 1009-10 (2nd Cir. 1991).

[114] *Columbia Packing Co. v. PBGC*, 81 B.R. 205 (D. Mass. 1998); *In re Greater Southeast Community Hosp. Found., Inc.*, 267 B.R. 7 (Bankr. D.C.. 2001).

[115] *In re Sunarhauserman, Inc.*, 126 F.3d 811 (6th Cir. 1997); *In re Kent Plastics Corp.*, 183 B.R. 841 (Bankr. S.D. Ind. 1995); *In re Chateaugay Corp.*, 115 B.R. 760, 771-78 (Bankr. S.D.N.Y. 1990).

[116] 29 U.S.C. § 1306(a)(7)(B), (C). The premium will not be triggered, however, if the plan is terminated in a distress termination by a debtor in a liquidation case. 29 U.S.C. § 1306(a)(7)(A) (imposing termination premiums on plans terminated during reorganization proceedings under 29 U.S.C. § 1341(c)(2)(B)(ii) but not during liquidation proceedings under 29 U.S.C. § 1341(c)(2)(B)(i)). Although one case has held that the premium is not triggered where there is a plan of liquidation (*i.e.*, a liquidating chapter 11 case), *In re USA Commercial Mort'g Co.*, Case No. 06-00725 (Bankr. D. Nev. July 18, 2008), it is not clear whether the premium is triggered if the plan is terminated in an

In *In re Oneida, Ltd.*, the first case to address the issue, the New York bankruptcy court found that the plan termination premium claim asserted by the PBGC was a prepetition unsecured "claim" for bankruptcy purposes that could be discharged under the debtor's plan of reorganization.[117] On appeal, however, the Second Circuit ultimately held that the PBGC's claim is a post-emergence obligation that is not dischargeable in a chapter 11 reorganization and must be paid in whole dollars.[118]

D. Controlled Group Liability

ERISA provides that all members of a plan sponsor's "controlled group" bear joint and several liability for minimum funding contributions, unpaid premiums, and termination (or in the case of multi-employer plans, withdrawal) liability.[119] As a result, for instance, a private equity fund can be held jointly and severally liable for the pension liabilities of its portfolio companies.[120] If members of the controlled group are not debtors in bankruptcy, the PBGC can proceed against those members and would not ordinarily be stopped by the automatic stay.[121] The PBGC may also object to certain transactions in bankruptcy that could reduce its ability to recover from group members (e.g., sale of a non-debtor subsidiary that eliminates the PBGC's structural seniority).

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involuntary termination in a liquidating case, or if a reorganization case is converted after plan termination.

[117] *In re Oneida, Ltd.*, 2008 WL 516493, *13 (Bankr. S.D.N.Y. Feb. 27, 2008).

[118] *PBGC v. Oneida, Ltd.*, 562 F.3d 154 (2d Cir. 2009).

[119] *See* 29 U.S.C. §§ 1082(c)(11)(B), 1307(e)(2), and 1362.

[120] *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129 (1st Cir. 2013), *cert. denied*, 134 S. Ct. 1492 (2014).

[121] *In re Caesar's Entertainment Op. Co., Inc.*, 540 B.R. 637 (Bankr. N.D. Ill. 2015) (ERISA's treatment of controlled group members as a single employer does not mean imposition of joint and several withdrawal liability on non-debtors violates the automatic stay).

Membership in a plan sponsor's controlled group generally depends on whether the affiliate (i) is engaged in a "trade or business," and (ii) shares common ownership with the employer of at least 80%.[122] Members may be corporate parents, subsidiaries or siblings, foreign or domestic.[123] Entities that were members within five years before plan termination (or withdrawal) may still be liable if the principal purpose of ceasing to be a member of the controlled group was to evade liability.[124]

In *Sun Capital*, the Court of Appeals for the First Circuit focused on the role played by a management company affiliated with private equity funds that owned Scott Brass, Inc. Reversing the district court, which had concluded on summary judgment that the funds were not a "trade or business" but merely passive investors,[125] the First Circuit found that at least one of the Sun Capital funds was indeed engaged in a "trade or business" and remanded to the District Court for the District of Massachusetts for determination of the second prong of ERISA's controlled group test.[126]

In considering whether the Sun Capital funds were engaged in a trade or business, the First Circuit relied upon an "investment plus" test—*i.e.*, examining the funds' actions over and

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[122] *See* 29 U.S.C. § 1301(b)(1); IRC § 414. *See also Sun Capital*, 724 F.3d at 138 ("To impose withdrawal liability on an organization other than the one obligated to the [pension] Fund, two conditions must be satisfied: 1) the organization must be under 'common control' with the obligated organization, and 2) the organization must be a trade or business.") (quoting *McDougall v. Pioneer Ranch LP*, 494 F.3d 571, 577 (7th Cir. 2007)).

[123] *See, e.g., In re AMR Corp.*, Case No. 11-15463, Stipulation and Agreement Between Debtors and PBGC [Dkt. No. 2602] (Bankr. S.D.N.Y.) (resolving PBGC's filing of liens against assets of foreign members of controlled group); *Pension Benefit Guar. Corp. v. Asahi Tec Corp.*, 979 F. Supp. 2d 46, 58 (D.D.C. 2013) (finding Japanese parent of debtor Metaldyne Corp. subject to personal jurisdiction and liable for unfunded benefit liabilities as a member of controlled group).

[124] 29 U.S.C. § 1369.

[125] *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 903 F. Supp. 2d 107, 148-49 (D. Mass. 2012).

[126] *Sun Capital*, 724 F.3d at 148.

above their investment in the portfolio company.[127] The test asks "(1) whether the private equity fund was engaged in an activity with the primary purpose of income or profit and (2) whether it conducted that activity with continuity and regularity."[128] The First Circuit concluded that at least one of the funds "sufficiently operated, managed, and was advantaged by its relationship with its portfolio company,"[129] by, among other things, its involvement in hiring, termination, and compensation decisions, creation of operating and restructuring plans, control of the debtor's board, and supply of management and consulting personnel, and receiving "a direct economic benefit…that an ordinary, passive investor would not derive: an offset against the management fees it otherwise would have paid its general partner for managing the investment."[130] The court relied in part on the funds' private placement memos to find active and intimate involvement in the management and operation of the portfolio company, noting that "[i]t is the purpose of the Sun Funds to seek out potential portfolio companies that are in need of extensive intervention with respect to their management and operations, to provide such intervention, and then to sell the companies."[131]

On remand, the district court applied the analysis set forth by the First Circuit and concluded that both Sun Capital funds were engaged in a trade or business,[132] and that they shared common ownership with the debtor on an aggregated basis (*i.e.*, notwithstanding their

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[127] *Id.* at 141.
[128] *Id.* at 139 (derived from *Comm'r of Internal Revenue v. Groetzinger*, 480 U.S. 23 (1987)).
[129] *Id.* at 133.
[130] *Id.* at 142-43.
[131] *Id.* at 142.
[132] *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund,* 172 F.Supp.3d 447, 445-45, 457-58 (D. Mass. Mar. 28, 2016).

purposeful structuring of corporate ownership and division of interests (30/70) to avoid the 80% threshold).[133] The decision is pending appeal to the First Circuit.

It should be noted that although the determination of controlled group liability for pension plan claims and the determination of affiliate liability for WARN Act claims (discussed further above) have analogous goals, they employ different tests developed separately. It is perhaps coincidence that Sun Capital funds figure prominently in the caselaw regarding both *In re Jevic* (finding insufficient involvement in management and operations to impose single-employer liability for WARN Act claims)[134] and *Sun Capital* (finding more than sufficient involvement to impose controlled group liability for pension obligations).

III. COLLECTIVE BARGAINING ISSUES IN BANKRUPTCY

A. Treatment of Prepetition Collective Bargaining Agreements in Chapter 11

Unlike most other executory contracts, collective bargaining agreements ("CBAs") are subject to a variety of other federal statutes, including the National Labor Relations Act, the Railway Labor Act, and the Norris-LaGuardia Act, that are fiercely protected by organized labor and unions. These labor interests were dealt a severe blow in 1984 when the United States Supreme Court found that a CBA could be rejected as an executory contract under section 365 of the Bankruptcy Code.[135] In *Bildisco* the Supreme Court held that a while a trustee or debtor is obligated to bargain in good faith under the National Labor Relations Act on the terms of a new

[133] *Id.* at 10-14.
[134] 526 B.R. 547 (D. Del. 2014).
[135] *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 523-524 (1984).

CBA, the trustee or debtor in possession is not guilty of an unfair labor practice by unilaterally altering or breaching the terms of a CBA before formal action by a bankruptcy court.[136]

In response to the decision in *Bildisco* and the ensuing pressure from labor interests, Congress enacted section 1113 of the Bankruptcy Code only five months after the *Bildisco* decision. The new statute overruled *Bildisco*, laying out in subsections 1113(b) and (c) the procedural and substantive steps that a trustee or debtor in possession must take in order to reject a CBA in a chapter 11 case.[137] Section 1113 was not the subject of separate House and Senate committee hearings or reports and was added to other provisions during a conference committee just prior to final enactment.[138] Courts have noted that as a result, the statute is "not a

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[136] *Id.* at 534.

[137] Sections 1113(b) and (c) provide:

> (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.
>
> (c) The court shall approve an application for rejection of a collective bargaining agreement 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.

[138] H.R. Rep. No. 98-882 (1984) (Conf. Rep.).

masterpiece of draftsmanship."[139] The lack of legislative history has caused courts consternation in attempting to interpret and apply the statute's often ambiguous terms.[140]

B. Rejection of a CBA under Section 1113

Courts applying section 1113 of the Bankruptcy Code have formulated a nine-part test to determine whether a CBA may be rejected:[141]

1. the debtor in possession must make a proposal to the union to modify the CBA;
2. the proposal must be based on the most complete and reliable information available at the time of the proposal;
3. the proposed modifications must be necessary to permit the reorganization of the debtor;
4. the proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably;
5. the debtor must provide to the union such relevant information as is necessary to evaluate the proposal;
6. the debtor must meet at reasonable times with the union;
7. the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the CBA;
8. the union must have refused to accept the proposal without good cause; and
9. the balance of the equities must clearly favor rejection of the collective bargaining agreement.

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[139] *In re Am. Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

[140] *In re Family Snacks, Inc*., 257 B.R. 884, 891-92 (B.A.P. 8th Cir. 2001) ("Congress provided courts with no meaningful legislative history to decipher and clarify Congressional intent or to interpret and apply the statute's substantive, often ambiguous terms.").

[141] The test was first used in *In re Am. Provision Co.*, 44 B.R. at 908-09, and has been followed by other courts. *See, e.g.*, *In re Family Snacks, Inc.*, 257 B.R. at 892 (noting that "virtually every court" uses this nine-part test); *Wheeling-Pittsburg Steel Corp. v. United Steelworkers of Am., AFL-CIO-CLC*, 791 F.2d 1074, 1080-81 (3rd Cir. 1986). Certain courts have consolidated the parts, resulting in a seven-part analysis. *See, e.g.*, *In re Carey Transp., Inc.*, 50 B.R. 203, 207-12 (Bankr. S.D.N.Y. 1985), *aff'd sub nom Truck Drivers Local 807, Int'l Bhd. of Teamsters, Chauffeurs, Warehousemen & Helpers of Am.v. Carey Transp., Inc.*, 816 F.2d 82 (2d Cir. 1987).

C. Frequent Issues in Applying Sections 1113(b) and (c)

1. The "necessity" of proposed modifications

In the third part of the test, section 1113(b)(1)(A) requires that the proposal made to the union representative "provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor."[142] Courts have focused on the use of the word "necessary" and how it is defined in the context of the statute. There is currently a split among the Courts of Appeals for the Third Circuit and for the Second and Tenth Circuits on how strictly to interpret "necessary" as used in the statute.

In *Wheeling-Pittsburg Steel Corp.*,[143] the Third Circuit took the more restrictive interpretation and found that a proposed modification to a CBA must be "essential" to prevent liquidation in the short term, in the same manner that "essential" is used in section 1113(e) (discussed below).[144] The court found that "necessary" in this context did not mean merely "desirable" but instead that the proposed modification must be directly related to the debtor's short term financial condition and its ability to reorganize.[145]

The Second and Tenth Circuits have taken the more flexible interpretation and found that a proposed modification to a CBA only needs to "increase the likelihood of a successful reorganization."[146] In taking its position, the Second Circuit explicitly rejected the *Wheeling*

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[142] 11 U.S.C. § 1113(b)(1)(A).

[143] *Wheeling-Pittsburg*, 791 F.2d at 1088.

[144] 11 U.S.C. § 1113(e) ("essential to the continuation of the debtor's business").

[145] *Wheeling-Pittsburg*, 791 F.2d at 1088-89.

[146] *See Carey Transp.*, 816 F.2d at 89; *In re Mile-Hi Metal Sys., Inc.*, 899 F.2d 887, 897 (10th Cir. 1990).

court's interpretation, calling it "troubling."[147] A majority of other courts have adopted the more flexible approach rather than the strict approach espoused in *Wheeling-Pittsburg*.[148]

2. Refusal must be without good cause

In the eighth part of the test, section 1113(c)(2) requires that if the debtor has complied with parts 1 through 7 of the test, the union's refusal to accept the debtor's proposal must be "without good cause." This effectively switches the burden from the debtor to the union.[149] The union must then "articulate and discuss in detail … its reasons for declining to accept the debtor's proposal in whole or part."[150] "Good cause" has been described by one court as:

> [F]oster[ing] the goals of good faith negotiations and voluntary modifications. It induces the debtor to propose only those modifications necessary to a successful reorganization while protecting the debtor against the union's refusal to accept its proposal without a good reason. Where the union rejects a proposal that is necessary, fair and equitable, it must explain the reasons for its opposition. On the other hand, if the union makes counter-proposals that meet its needs while preserving the savings required by the debtor, its rejection of the debtor's proposal will be with "good cause."[151]

Courts have held that a union may not stonewall or refuse to negotiate with the debtor over their proposal.[152] Even if the union has a principled reason for rejecting the proposal that when considered from a self-interested viewpoint is reasonable, it may still be found to have rejected the modification "without good cause."[153]

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[147] *Carey Transp.*, 816 F.2d at 89.

[148] *See In re Mesaba Aviation, Inc.*, 341 B.R. 693, 731 (D. Minn. 2006) ("The *Carey Transp.* standard appears to have taken a majority among subsequent published decisions.").

[149] *See Carey Transp.*, 816 F.2d at 92

[150] *In re Royal Composing Room, Inc.*, 62 B.R. 403, 407 (Bankr. S.D.N.Y. 1986), *aff'd*, 78 B.R. 671 (S.D.N.Y. 1987), *aff'd*, 848 F.2d 345 (2d Cir. 1988).

[151] 7-1113 COLLIER ON BANKRUPTCY ¶ 1113.05 (quoting *In re Horsehead Indus.*, 300 B.R. 573, 588 (Bankr. S.D.N.Y. 2003)).

[152] *See In re Blue Diamond Coal Co.*, 131 B.R. 633, 644 (Bankr. E.D. Tenn. 1991); *Horsehead Indus.*, 300 B.R. at 588.

[153] *In re Salt Creek Freightways*, 47 B.R. 835, 840 (Bankr. D. Wyo. 1985).

D. Interim Relief Under Section 1113(e)

Under section 1113(e), the court may grant a debtor interim relief from a CBA if the debtor is able to show that the relief is "essential to continuation of the debtor's business" or required "in order to avoid irreparable damage to the estate."[154] The legislative history of section 1113(e) provides that the standard for demonstrating that interim changes are "essential to continuation of the debtor's business" is the *REA Express* standard for rejecting collective bargaining agreements.[155] The *REA Express* standard, developed by the Second Circuit, is:

> ...in view of the serious effects which rejection has on the carrier's employees it should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs.[156]

Another court has held that the term "essential" in the context of 1113(e) "should be limited to the bare minimum, short term requirements for the debtor's immediate survival."[157] Generally, to obtain interim relief, a debtor must show that liquidation will be an immediate consequence in the absence of the requested interim relief. In light of the grave danger that a

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[154] Section 1113(e) provides:

> (e) If during a period when the collective bargaining agreement continues in effect, and if essential to the continuation of the debtor's business, or in order to avoid irreparable damage to the estate, the court, after notice and a hearing, may authorize the trustee to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by a collective bargaining agreement. Any hearing under this paragraph shall be scheduled in accordance with the needs of the trustee. The implementation of such interim changes shall not render the application for rejection moot.

[155] *See In re Salt Creek Freightways*, 46 B.R. 347, 349 (Bankr. D. Wyo. 1985) (citing 130 Cong. Rec. H7496 (daily ed. June 29, 1984) (remarks of Representatives Morrisen and Lungren); 130 Cong. Rec. S8898 (daily ed. June 19, 1984) (remarks of Senator Packwood)).

[156] *Bhd. of Ry., Airline & S. S. Clerks, Freight Handlers, Exp. & Station Emp., AFL-CIO v. REA Exp., Inc.*, 523 F.2d 164, 172 (2d Cir. 1975).

[157] *In re United Press Int'l, Inc.*, 134 B.R. 507, 514 (Bankr. S.D.N.Y. 1991).

company must be in to be authorized relief under this standard, the trustee is not required by 1113(e) to negotiate with or provide information to the union before seeking interim relief.[158]

E. Section 1114 – Payment of Insurance Benefits to Retired Employees

Section 1114 of the Bankruptcy Code was added in 1998, fourteen years after section 1113. It was added to impose requirements, similar to those in section 1113, regarding the modification of benefits to retired employees in the event bargaining is not successful. "Retiree benefits" as used in section 1114 has been defined as including plans, funds or programs provided to retired employees, their spouses, and their dependents for health care, accident, disability, and death benefits.[159] While having many similarities to the protections provided in section 1113, the provisions of section 1114 apply to union and non-union retirees alike.[160]

IV. RETENTION AND COMPENSATION OF KEY EMPLOYEES

A. Key Employee Retention Plans

Before Congress enacted the BAPCPA in 2005, debtors in chapter 11 could offer a lump sum monetary compensation package to their "key" employees so long as the employee remained employed by the debtor through some specified date. These plans were known as Key Employee Retention Plans ("KERPs"). The debtor would file a motion with the court to approve the KERP under sections 105 and 363 of the Bankruptcy Code. Courts would consider the KERP under the business judgment rule.[161] Additionally, the obligations that the debtor incurred

[158] 7-1113 COLLIER ON BANKRUPTCY ¶ 1113.07.

[159] *See* 11 U.S.C. § 1114(a); *Adventure Res., Inc. v. Holland*, 137 F.3d 786, 795 (4th Cir. 1998), *cert. denied*, 525 U.S. 962 (1998).

[160] 11 U.S.C. § 1114(b).

[161] *In re Montgomery Ward Holding Corp*., 242 B.R. 147, 153 (Bankr. D. Del. 1999).

under the KERP would be treated as administrative-expense priority claims under section 503 of the Bankruptcy Code. Until the enactment of the BAPCPA, KERPs were routinely approved.

Following the enactment of BAPCPA and its addition of section 503(c) of the Bankruptcy Code,[162] it became considerably more difficult for a debtor to provide this type of "pay to stay" incentive to management and other key employees.

Section 503(c)(1) prohibits transfers made to or obligations incurred for the benefit of insiders "for the purpose of inducing such person to remain with the debtor's business" absent

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[162] Section 503(c) provides:

> (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 the evidence in the record that—
>
> (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;
>
> (B) the services provided by the person are essential to the survival of the business; and
>
> (C) either—
>
> (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 which the transfer is made or the obligation is incurred; or
>
> (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;
>
> (2) a severance payment to an insider of the debtor, unless—
>
> (A) the payment is part of a program that is generally applicable to all full-time employees; and
>
> (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
>
> (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.

certain very restrictive factors.[163] Section 503(c)(2) prohibits severance payments to an insider unless it is a part of a larger program available to all employees and is not substantially larger than the severance payments made to nonmanagement employees during the same year. Section 503(c)(3) operates as a catch-all provision for other arrangements.[164] The restrictions of subsections (c)(1) and (c)(2) severely curtailed the ability of a debtor to compensate its management and insiders through retention policies, but subsection (c)(3) kept the door open for debtors to provide compensation through programs that were incentive-based as opposed to retentive in nature.

B. Key Employee Incentive Plans

As a response to the now-disfavored KERPs, debtors began to offer their critical employees Key Employee Incentive Plans ("KEIPs"). A KEIP does not compensate an employee merely for just continued employment with the debtor but is intended to incentivize performance by those employees, incorporating performance targets such as the sale of assets or meeting of certain financial metrics. Due to the nature of the compensation, KEIPs are not subject to the restrictions of section 503(c)(1) but are instead subject to the more general provisions of 363(b)(1) and section 503(c)(3) of the Bankruptcy Code. Section 503(c)(3) prohibits transfers to employees "that are outside the ordinary course of business and not justified by the facts and circumstances of the case." Courts differ on what "justified by the facts and circumstances of the case" means, but several courts have held that the test under section 503(c)(3) is the same as the business judgment test under section 363(b)(1).[165] In *Dana Corp*. the court ruled that section

[163] Insiders include directors, officers, and others in control of a corporate debtor. 11 U.S.C. § 101(31).
[164] 4-503 COLLIER ON BANKRUPTCY ¶ 503.17.

503(c)(3) "gives the court discretion as to bonus and incentive plans, which are not primarily motivated by retention or in the nature of severance."[166]

A debtor must be careful in setting the performance standards when proposing the KEIP in order to avoid setting them so low as to be perfunctory. A KEIP that sets the bar so low as to be meaningless may draw objections as being a KERP made to look like a KEIP in order to avoid the much stricter standards of 503(c)(1).[167] In *American Eagle*, a debtor proposed a KEIP that would have paid employees lump sums upon the consummation of a sale of substantially all of the debtor's assets or the confirmation of a plan of reorganization or liquidation.[168] That proposed KEIP drew objections from the U.S. Trustee and secured lenders who argued that the performance standards were not sufficiently difficult and the KEIP was nothing more than a disguised KERP.[169] The court ultimately found that while the KEIP had "retentive" elements, it was in fact an incentive plan.[170]

V. EMPLOYEE CLAIMS

Sections 507(a)(4) and (5) of the Bankruptcy Code provide for priority treatment of certain categories of allowed unsecured claims—for wages, salaries, commissions and

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[165] *In re Dana Corp*., 358 B.R. 567 (Bankr. S.D.N.Y. 2006). *See, e.g.*, *In re Dewey & LeBoeuf LLP*, 2012 WL 3065275 (Bankr. S.D.N.Y. July 30, 2012); *In re Global Aviation Holdings Inc*., 2012 WL 3018064 (Bankr. E.D.N.Y. July 24, 2012); *In re Velo Holdings Inc*., 472 B.R. 201 (Bankr. S.D.N.Y. 2012); *In re Borders Group, Inc.*, 453 B.R. 459 (Bankr. S.D.N.Y. 2011); *In re Mesa Air Group, Inc*., 2010 WL 3810899 (Bankr. S.D.N.Y. Sept. 24, 2010); *In re Nobex Corp*., 2006 WL 4063024 (Bankr. D. Del. Jan. 19, 2006). *But see In re Pilgrim's Pride Corp*., 401 B.R. 229 (Bankr. N.D. Tex. 2009) (payments under section 503(c)(3) may be granted administrative-expense priority only if the court finds, independent of the debtor's business justification, that the payment is in the best interest of the parties).

[166] *Dana Corp*., 358 B.R. at 576.

[167] *In re Am. Eagle Energy Corp*., No. 15-15073 HRT, 2016 WL 3573952 (Bankr. D. Colo. June 23, 2016).

[168] *Id.* at *3.

[169] *Id*. at *1.

[170] *Id.* at *3.

contributions to employee benefit plans that are earned by employees or arise from services rendered by them during a certain time period.[171] "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."[172] As of April 1, 2016, these priority claims are capped at $12,850. This cap amount is adjusted every three years to "reflect the change in the Consumer Price Index for All Urban Consumers."[173]

A. Wages, Salaries, and Commissions

The fourth priority, provided for under section 507(a)(4), is for allowed unsecured claims earned within 180 days before the petition date for "wages, salaries, commissions, including vacation, severance, and sick leave pay earned by an individual." This claim is statutorily capped

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[171] Sections 507(a)(4) and (5) provide:

> (a) The following expenses and claims have priority in the following order
>
> > (4) Fourth, allowed unsecured claims, but only to the extent of $12,850 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—
> >
> > > (A) wages salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or
> > >
> > > (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.
> >
> > (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
> > >
> > > (B) for each such plan, to the extent of—
> > >
> > > > (i) the number of employees covered by each such plan multiplied by $12,850; less
> > > >
> > > > (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.

[172] 4-507 COLLIER ON BANKRUPTCY ¶ 507.02.

[173] 11 U.S.C. § 104.

at $12,850 for each employee and any amount in excess of this cap will be treated as a general unsecured claim. This section does not however include employer contributions to life insurance, workers compensation, or stock options.[174]

A claim is eligible under section 507(a)(4) only if it was earned during the 180 days prior to the earlier of the filing of the petition or the cessation of the debtor's business. The latter was included as an alternative measuring date to protect the priority of claims if the debtor discontinues its business but delays the filing of a bankruptcy case.[175] Wages, salaries, and commissions are "earned" when the employee is vested with the right to payment as opposed to the time that the payment is scheduled to be made.[176]

While the calculation of when a wage, salary, or commission has been earned is relatively straightforward, determining the timing of when severance and vacation compensation has been earned can be more difficult. The Bankruptcy Code does not provide for how these two benefits should be calculated. An employee who, due to termination of employment, has earned severance payments within the 180 day period before the petition date is eligible for priority under section 507(a)(4). If the employee's termination occurred before the 180 day window before the petition date, the employee's severance will not qualify for priority because the severance payments were not "earned" within the 180 day window, even if the severance

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[174] *See Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 658 (2006); *In re 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…").

[175] *See* 4-507 COLLIER ON BANKRUPTCY ¶ 507.06[4].

[176] *See In re 710 Long Ridge Road Operating Co. II, LLC*, 505 B.R. 163 (Bankr. D.N.J. 2014) (back pay claims attributable to a period before the 180-day period do not qualify for priority even though the back pay award was rendered during such period); *In re Murray Indus. Inc*., 114 B.R. 749 (Bankr. M.D. Fla. 1990) (claim for damages/lost wages due to employer's breach of employment contract accrues at time of termination and claim not entitled to priority where termination occurred prior to the applicable period); *see also* 4-507 COLLIER ON BANKRUPTCY ¶ 507.06[5].

payments were payable during that time period.[177] Regarding a claim for severance benefits, courts will typically determine what portion was earned within the 180 days prior to filing by starting with "the total severance benefits payable and multiply[ing] 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."[178]

B. Employee Benefit Plan Contributions

Prepetition employee benefits receiving priority under section 507(a)(4) do not include certain other benefits such as employer contributions to life insurance and annuity benefits.[179] These types of benefits are covered under section 507(a)(5) of the Bankruptcy Code. The purpose of this section is to encompass those benefits and give them a priority status.[180] The cap in section 507(a)(5) is not in addition to the cap in 507(a)(4), but instead is cumulative.[181]

Section 507(a)(5) does not define what an "employee benefit plan" is and courts have used a variety of approaches in determining which plans should be awarded priority under this provision. Despite the lack of a specific reference in section 507(a)(5) to ERISA, some courts looked to ERISA to appropriate the definition of "employee benefit plan" therein. The Supreme Court has held, however, that bankruptcy courts should not read that definition into section

[177] *See In re General Info. Servs., Inc.*, 68 B.R. 419 (Bankr. E.D. Pa. 1986) (no priority for severance benefits payable within applicable period because employee terminated prior to applicable period and employee's right to payments earned at that time).

[178] 4-507 COLLIER ON BANKRUPTCY ¶ 507.06[5][b][i] (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).

[179] *Howard Delivery Serv.*, 547 U.S. 651 (2006).

[180] *Id.* at 659.

[181] *Id.*

507(a)(5), stating that "[n]o such directions are contained in §507(a)(5), and the Court has no warrant to write them into the text."[182]

C. A Potential Problem: D&O Liability

Although it is not uncommon for states to have laws that impose personal liability on members of management who are directly responsible for certain labor-related claims (for example, non-payment of employee wage claims), and although we do not find that such statutes impose personal liability broadly for the acts of the company, companies have raised concerns about a relatively new provision in the California Labor Code that may be stepping in that direction. Effective January 1, 2016, California's Labor Code was amended to provide for the liability of any "other person" acting for an employer who causes a violation of certain labor regulations:

> (a) Any employer or other person acting on behalf of an employer, who violates, or causes to be violated, any provision regulating minimum wages or hours and days of work in any order of the Industrial Welfare Commission, or violates, or causes to be violated, Sections 203, 226, 226.7, 1193.6, 1194, or 2802, may be held liable as the employer for such violation.[183]

The Labor Code defines the term "other person" as "a natural person who is an owner, director, officer, or managing agent of the employer."[184] The scope of this provision is at issue in approximately two dozen pending cases so far.

Although directors and officers may feel insulated by the notion that a company's acts are not normally ascribed to them personally (absent unusual circumstances), the California provision's language regarding "causing to be violated" troublingly suggests that voting to take (and executing) actions that affect employees may result in personal liability. Typically, D&O

[182] *Id.* at 652.
[183] Cal. Lab. Code § 558.1(a).
[184] *Id.* at § 558.1(b).

insurance policies have exclusions for personal bad acts, including willful violations of law. At this point, it is unclear whether issuers of D&O policies would, or to what extent they successfully could, deny coverage (and defense) to directors and officers on this basis.

For potential personal liability for failure to comply with the WARN Act, there is nothing in the statute to suggest that officers and directors would bear personal liability in connection with a company's failure to comply with the notice requirement. State analogs of the WARN Act may be less straightforward,[185] and we cannot say with 100% certainty that there is no possibility of personal liability for intentionally violating those laws. However, at this time we are not aware of personal liability being imposed on directors and officers under federal or state WARN statutes.[186]

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[185] For example, California's statute is a bit vague and untested. *See* Cal. Lab. Code § 1400 ("'Employer' means any person, as defined by Section 18 [*i.e.*, including natural persons] who directly or indirectly owns *and operates* a covered establishment.") (emphasis added).

[186] The new California statute imposing personal liability for wage-related claims would not apply to failure to pay WARN Act statutory payments.