

## WARN Act Liability: Critical Guidance for Investors and Lenders to Distressed Businesses

By Bob Keach and Lori Dwyer | August 4, 2011

In a July 8, 2011 decision of critical interest to private equity firms and lenders, *D'Amico v. Tweeter OPCO*, 2011 WL 2680838 (Bankr. D. Del.), the bankruptcy court for the District of Delaware extended liability under the Worker Retraining and Notification Act (“WARN”) to an investor/lender to the distressed company. The *D'Amico* case provides critical guidance for those lending to or investing in businesses that may be conducting plant closings or mass layoffs. Given the Delaware court’s role in numerous large restructuring cases, the case stands as influential precedent, likely to be applied by other courts.

The WARN Act provides that covered employers generally may not conduct plant closings or mass layoffs resulting in the loss of 50 or more jobs at a single site of employment without first providing at least 60 days’ written notice to affected workers. To be covered under the WARN Act, a company must employ 100 or more full-time workers. Courts typically award back pay, benefits and attorney fees to laid off or terminated employees to remedy WARN Act violations. Certain exceptions may apply where the company is searching for investment to save the business, or the circumstances dictating the closing were not predictable, but even then the company must provide as much notice as is possible. Generally, the liability runs only to the “employer” of the affected employees.

Vexing issues can arise in cases where parent, grandparent and, as in this case, great-great grandparent companies, as well as lenders and investors to distressed companies, play a role in the decision to conduct a plant closing or mass layoff. The interest holder or lender can, in that case, unwittingly incur WARN Act liability by assuming the role of “employer” as a matter of law.

In *D'Amico*, the debtor had provided only one-day’s notice of plant closings to affected employees working in its Massachusetts and Pennsylvania locations. The laid-off employees immediately brought suit against the debtor and non-debtor lender/owner, Schultze Asset Management, LLC (“SAM”), for WARN Act violations.

On paper, SAM was judiciously removed from the debtor. George Schultze (“Schultze”) and his family owned 100% of SAM. SAM was a general partner and owner of 1-2% of the limited partnership interests in Schultze Partners, LP. Schultze Partners, LP owned 37% of Schultze Master Fund, Ltd. which owned 100% of Schultze Holding Corp., which, in turn, owned 82% of Tweeter Newco, LLC. Tweeter Newco owned 100% of the debtor. In other words, SAM was a 1-2% owner four times removed from the debtor. SAM was also a significant lender to Tweeter Newco, the debtor, and related debtor entities.

The central question before the Court was whether SAM and the debtor were nonetheless a “single employer” for purposes of the WARN Act, such that SAM could be held liable for WARN Act violations. Reiterating that the single employer test looks fundamentally at whether two “nominally separate entities operated at arm’s length,” the Court considered the typical five factor test to determine single employer status: (1) common ownership; (2) common directors and/officers; (3) the *de facto* exercise of control; (4) unity of personnel policies from a common source; and (5) the dependence of operations between the entities.

In holding that SAM and the debtor were a “single employer” under the WARN Act, the court focused on *de facto* control as the central issue, specifically highlighting the following facts:

- o Schultze (SAM’s managing member, *de facto* CEO, and boss, as well as CEO and the Managing Member of Tweeter Newco) repeatedly called for reductions in the debtor’s payroll to increase profits;
- o Schultze ordered an employee of SAM to meet with Tweeter’s management and instruct them to terminate the debtor’s employees shortly before the layoffs;
- o SAM’s inside counsel supervised the action of the debtor vis a vis the layoffs;
- o Five of SAM’s employees sat on the debtor’s board; and
- o SAM directed the termination of the debtor’s CEO, citing in an email to employees the need for SAM to retain “tighter control over Tweeter.”

The Court also held that because of SAM's "significant indirect ownership" in the debtor and its exercise of financial control over the debtor through its lender relationship, it met the "common ownership" factor. Finally, given Schultze's role as managing member of both SAM and Tweeter Newco, *de facto* CEO of SAM and boss of the SAM employees, the "common directors and officers" prong was satisfied.

This decision underscores the critical importance of creating clear, unequivocal boundaries between the non-debtor lender/investor and the distressed company. Because the "*de facto* control" factor is the most important, such companies should consider hiring independent restructuring officers to manage layoffs and key decisions. The restructuring professionals must be given significant decision-making authority and discretion, and the non-debtor lender/investor should avoid significant involvement in the company's decision to close facilities or terminate personnel. While lending might be conditioned on expense reduction targets or financial covenant compliance, a specific direction to conduct layoffs is very risky, as this case shows. Counsel experienced in restructurings and WARN Act compliance must be consulted at each juncture of the process.

If you have questions about WARN Act compliance or related issues, please contact Bob Keach, shareholder and co-chair of Bernstein Shur's Business Restructuring and Insolvency Practice Group, [rkeach@bernsteinshur.com](mailto:rkeach@bernsteinshur.com) or 207-228-7334, or Lori Dwyer, member of the Labor and Employment Law Practice Group, [ldwyer@bernsteinshur.com](mailto:ldwyer@bernsteinshur.com) or 207-228-7145.