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Directors And Officers May Be Liable For WARN Act Claims

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This article explores the significant impact a recent decision by the U.S. Bankruptcy Court for the District of Delaware will have in altering the already complex landscape of bankruptcy proceedings involving liability for the failure to issue proper notice under the Worker Adjustment Retraining Notification Act (WARN Act) and its state law equivalents. In *Stanziale v. MILK072011 LLC*, Case No. 13-10044 (KG), Adv. Pro. No. 14-50953 (KG) (Bankr. D. Del. Sept. 21, 2015), in the context of denying a motion to dismiss a complaint, the Bankruptcy Court became the first court to hold that the controlling owner, manager and president — each of whom owe a fiduciary duty to the Delaware limited liability company they serve — may have breached their fiduciary duties by not giving the requisite notice.

Nature of WARN Act Liability

No matter what discipline, many attorneys have wrestled with some aspect of WARN Act liability. The WARN Act was passed in 1988 as Congress' response to a series of plant closings. It applies to all businesses with at least 100 full-time employees, calculated on the day the WARN notice is due, as opposed to the date on which a mass layoff or shutdown occurs. The WARN Act requires employers to give employees at least 60 days' notice of a plant closing or a mass layoff. If an employer fails to provide that notice, in the absence of a statutory exception such as the "faltering company" or "unforeseen business circumstances" exceptions, it may be held liable for back pay, with interest, ERISA coverage, civil penalties and attorneys' fees. Federal courts have not extended liability for WARN Act violation to officers and directors, except when the plaintiffs could pierce the corporate veil, relying on alter-ago theories of liability.

The Bankruptcy Court Proceeding

The debtor, Golden Guernsey Dairy LLC, was a dairy manufacturing business located in the Upper Midwest. In late 2011, a private equity firm acquired the debtor and formed MILK072011 to act as the sole member of the debtor. On Dec. 26, 2012, the private equity firm directed the debtor to cease operations and promptly file a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. On Jan. 5, 2013, the debtor closed its doors. Three days later, on Jan. 8, 2013, the debtor filed its Chapter 7 petition. Thereafter, the Wisconsin Department of Workforce Development filed an amended proof of claim on behalf of some of the debtor's former employees claiming damages for an alleged violation of the Wisconsin WARN Act. The claim, which asserted a priority claim in an amount not less than $1.56

million, included a claim for wages and benefits that would have accrued during the 60 days' notice period.

On Nov. 4, 2014, the trustee initiated the adversary proceeding. In his complaint, the trustee alleged that the controlling owner, manager and president of the debtor — the LLC equivalents of directors and officers of a corporation — breached their fiduciary duties to the debtor in connection with the debtor's abrupt closure and bankruptcy filing by maintaining the debtor's business operations until the last moment, thereby exposing the debtor to a Wisconsin WARN Act claim. The trustee also alleged that the defendants ignored their responsibility to give an appropriate notice or notices to the debtor's employees and thereby exposed the debtor to the Wisconsin WARN Act claim.

As a result of the trustee securing the debtor's electronically stored information prior to the filing of the complaint, the trustee was able to allege, among other things, that the debtor and its management accurately projected in the debtor's 16-week cash flow forecast that the debtor would run out of cash in late December and that the debtor and the defendants knew of the requirements of the WARN Act and the Wisconsin WARN Act. In addition, as alleged in the complaint, the electronically stored information showed that the debtor and the defendants, despite full knowledge of the forecasted cash flow and the requirements of the WARN Acts, failed to give the requisite notices.

Unsurprisingly, when faced with this claim, which was not the subject of a reported decision, the defendants moved to dismiss the breach of fiduciary duty claims asserted in the complaint. The Bankruptcy Court found the trustee alleged facts, when taken as true on a motion to dismiss, supporting a finding that the defendants breached their fiduciary duties to the debtor by failing to give the requisite notice to the debtor's employees.

The Bankruptcy Court also rejected the defendants' argument that the breach of fiduciary duty cause of action was a disguised "deepening insolvency" claim and such a claim is not recognized under Delaware law. The Bankruptcy Court distinguished the trustee's breach of fiduciary duty claim from the deepening insolvency claim, disapproved in *Trenwick America Litigation Trust v. Ernst & Young LLP*, 906 A.2d 168 (D. Del. 2006), on the basis that the trustee's complaint alleged facts that represented misconduct on the part of the defendants and not one in which the defendants made strategic errors or imprudent investments.

Likewise, the Bankruptcy Court rejected the defendants' argument that debtor suffered no damages as a result of the Wisconsin WARN Act claim. The defendants argued that the fact that the insolvent debtor's liabilities grew from the violation was unfortunate but did not give rise to a cause of action. The Bankruptcy Court found that the increase in liabilities damaged the debtor.

Why Stanziale v. MILK072011 Matters

In bankruptcy proceedings, WARN Act liability claims are often significant in amount. Prior to this decision, no federal courts found that directors and officers may be liable to the bankrupt corporation for these amounts without a piercing of the corporate veil. In effect, by failing to give the requisite notice, directors and officers may be indirectly exposing themselves to WARN Act liability. The potential exposure to these amounts should impact on pre-bankruptcy planning by making it more likely that a company will give the requisite notice. In addition, insurers should take notice as an increase in the litigation of breach of fiduciary cases for failure to give the requisite notice is likely to result in claims for coverage under directors' and officers' insurance policies. Attorneys, whom advise boards of directors and corporate management, should also take notice as clients should be counseled to provide the

requisite notice when operating a business that is forecasted to run out of cash.

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