

Can Officers and Directors Be Held Individually Liable Under State Law for Causing Employers to Violate the WARN Act?

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In the face of recent reductions-in-force and predictions of a recession (Harriet Torry & Anthony DeBarros, *Economists Now Expect a Recession, Job Losses by Next Year*, Wall St. J., Oct. 16, 2022), employment lawyers are dusting off their research regarding the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C. 2101 et seq., and similar state laws (the WARN Acts). These laws require employers to provide workers at least 60 days' advance notice of plant closings or mass layoffs.

Although the federal WARN Act has been in place for decades, only in recent years have courts addressed certain new theories for application of these laws to distressed companies considering the protections of the bankruptcy laws. In bankruptcy proceedings, employers have argued that WARN

Act damages arising prior to filing of the bankruptcy petition constitute "general unsecured claims" subject to significant reduction in ultimate recoveries by workers.

To avoid such reductions, plaintiffs have begun to assert, and courts have considered, a number of creative claims against officers and directors for their participation in the employer's violation of the WARN Acts.

At least two bankruptcy court decisions have allowed Chapter 7 trustees to assert certain state law claims for breach of fiduciary duty against officers and directors for causing the debtor to violate the WARN Act. In this article, we analyze one of these decisions and offer practical suggestions distressed employers should consider as they are contemplating compliance with the WARN Acts.



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Background

The federal WARN Act allows for civil actions by employees for damages in the form of back pay for each day of violation and benefits under any employee benefit plan which would have been covered under an employee benefit plan if the employment loss had not occurred. 29 U.S.C. 2104(a)(1).

Although the WARN Acts contain exceptions to the notice requirement for “unforeseeable business circumstances,” where the employer is a “faltering company” and for “natural disasters,” the existence of an employer’s financial distress or even a bankruptcy filing does not excuse liability under the WARN Acts. 29 U.S.C. §2102(b)(1)-(2); e.g., *Ien v. TransCare (In re TransCare)*, 614 B.R. 187, 209-11 (Bankr. S.D.N.Y. 2020).

Section 507(a) of the Bankruptcy Code lists and ranks ten categories of priority claims reflecting Congressional policy judgments for distribution of the debtor’s assets in the bankruptcy process. Applying the Code’s prioritization rules, courts have held that WARN Act back pay damages arising prior to the bankruptcy filing will be paid on a fourth or fifth level priority status. See, e.g., *Henderson v. Powermate Holding (In re Powermate Holding)*, 394 B.R. 765, 772 (Bankr. D. Del. 2008); see also *In re Hanlin Group*, 176 B.R. 329, 333-34 (Bankr. D.N.J. 1995) (WARN Act back pay damages are deemed wages earned upon termination of employment).

More specifically, 11 U.S.C. §507(a)(4)-(5) provide fourth priority status to unsecured claims for wages, salaries and commissions, vacation pay, severance pay, and sick leave pay earned by an individual, and fifth priority status to unsecured claims for contributions to an employee benefit plan. There is a maximum amount allowable per individual for such claims, and any amount exceeding that limit is a general unsecured claim, entitled to lower priority, which amount, therefore, will be paid at a lower level, and potentially at a fraction of its full value. *Id.* WARN Act damages arising after the filing of the bankruptcy petition are deemed administrative expenses and paid on a second priority basis. E.g., *In re Hanlin Group*, 176 B.R. at 333.

Courts historically have refused to hold individuals liable for a company’s failure to provide timely WARN notices. E.g., *Cruz v. Robert Abbey*, 778 F. Supp. 605, 609 (E.D.N.Y. 1991). Against this backdrop, in 2015 the Delaware bankruptcy court refused to dismiss the Chapter 7 trustee’s claims against the sole manager and president of an insolvent corporation for breach of fiduciary duty based on these individuals’ failure to cause the employer to provide the requisite 60-day notice under the WARN Act. See *Stanziale v. MILK072011 (In re Golden Guernsey Dairy)*, 548 B.R. 410 (Bankr. D. Del. 2015).

More recently, a New York bankruptcy court similarly considered whether the individual owner of the debtor entity breached her fiduciary duties of loyalty and good faith owed to the company when she failed to cause the employer to follow the WARN Act requirements. See *LaMonica v. Tilton, et al. (In re TransCare Corporation)*, No. 16-

‘In re TransCare’

In 2016, a network of paratransit and medical transit businesses commonly referred to as TransCare abruptly failed and commenced Chapter 7 bankruptcy proceedings. *len v. TransCare (In re TransCare)*, 638 B.R. 691, 696 (Bankr. S.D.N.Y. 2022). More than 1,000 employees were terminated with essentially no notice. At least two litigations ensued, each arising out of TransCare’s alleged failure to give timely WARN Act notice.

Shameeka len brought a class action against debtor TransCare Corporation and its wholly-owned subsidiary debtors, against non-debtor entities and their affiliates, as well as against Lynn Tilton, who owned and controlled the entity defendants. *Id.* len named Tilton as a defendant only on claims asserted under state wage payment law, not on the WARN Act claims. *Id.*

The Chapter 7 trustee commenced a separate adversary proceeding on behalf of the estates of TransCare and its debtor-affiliates against Tilton, TransCare, and its debtor-affiliates, asserting certain claims for relief, including claims for breach of fiduciary duties of loyalty and good faith against Tilton. *In re TransCare Corporation*, 2020 WL 8021060, at *1. After conducting a trial, the court ruled that Tilton breached her fiduciary duties by failing to maximize the value of TransCare when she decided to sell the company, and by formulating and executing a plan to restructure the business’s affairs through a foreclosure by secured lenders she controlled of certain assets to be transferred to an affiliated entity that Tilton also controlled. *Id.* at *23.

The trustee also claimed that Tilton breached her fiduciary duties to TransCare based on the failure of TransCare to give adequate notice of mass layoffs to its employees as required by the WARN Act. The trustee sought a declaratory judgment that Tilton was responsible for indemnifying the estate of TransCare for the WARN Act liability because (1) TransCare had no such liability prior to Tilton’s breach of loyalty and she must bear that liability in order to put TransCare back to where it was prior to the breach; (2) the WARN Act liability was a natural and foreseeable consequence of Tilton’s actions; and (3) under Delaware law, a corporate officer or director who knowingly causes the corporation to violate the law necessarily fails to act in good faith and thereby breaches her fiduciary duty of loyalty. *Id.* at *28.

According to the trustee, Tilton purposely chose not to issue a WARN Act notice because she did not want TransCare’s employees to look for new jobs. *Id.* at *29. The claim is based on an email exchange, which Tilton noted that she did not want to inform employees about the bankruptcy prior to the foreclosure because she “didn’t want to mass exodus.” *Id.*

The court concluded that the evidence relied on by the trustee did not support imposing an obligation on Tilton to indemnify the estate on the theory that she caused those violations in bad faith. *Id.* To establish bad faith, the court reasoned that the trustee had to demonstrate that Tilton’s conduct in failing to provide the WARN Act notice sooner

was “qualitatively more culpable than gross negligence.” Id. (quoting *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 66 (Del. 2006)).

The court noted that while Tilton did not want to give the notice until the foreclosure was completed, evidence showed that she still subjectively believed that TransCare had adequate time to send the WARN Act notices. Id. The trustee failed to show that Tilton deliberately delayed the timing of the WARN Act notices because she did not care about the requirements of the WARN Act or that her actions were the product of calculated wrongdoing or intentional disregard of her responsibilities with TransCare. Id.

Accordingly, while the court concluded that Tilton breached her fiduciary duties, as described above, the trustee did not submit sufficient evidence to prove that the breach was based on her causing TransCare to violate the WARN Act.

Practice Pointers

While the Chapter 7 trustee in *TransCare* was unable to prove that Tilton breached her fiduciary duty based on WARN Act violations, the court nonetheless considered the claim and evaluated whether the trustee submitted sufficient evidence of Tilton’s intentional disregard of her fiduciary duties. Future plaintiffs may be emboldened by *TransCare* to assert similar claims against officers and directors, in the hopes of proving a greater level of culpability than was shown in *TransCare*.

In response, officers and directors may argue that such state law claims for breach of fiduciary duty are preempted by the WARN Act and are otherwise not permitted by applicable state law. For example, at least one state court has held that employees had no standing to assert derivatively on behalf of their employer claims for breach of fiduciary duty against company officers for failure to provide timely WARN Act notices. See *Calixto v. Coughlin*, 113 N.E.3d 329, 335 (Mass. 2018). It remains to be seen how other courts will resolve these issues.

Future employers in financial distress, like TransCare, similarly may be tempted to avoid or delay issuing a WARN Act notice because of concern for adverse consequences to the business. For example, employers may be concerned that providing WARN notice may cause customers to discontinue transacting business with the employer or negatively impact employee morale. However, in light of the *In re TransCare* and *In re Golden Guernsey Dairy* distressed employers also should consider the risk of claims by terminated employees against their officers and directors. Employers also should consider the impact of such litigation in the form of claims by officers and directors against the employer for indemnification under corporate governance documents or for coverage under the employer’s insurance policies.

Obviously the easiest way for employers to avoid litigation resulting from violation of the WARN Acts is to arrange for sufficient notice to employees prior to plant closings or mass layoffs in compliance with those laws.

Where such notice is impracticable, employers should consider the application of the

exceptions to the notice requirements contained in the WARN Acts. But, even in cases where an exception applies, employers should be mindful of the requirement in the federal WARN Act that employers “shall give as much notice as is practicable and at that time shall give a brief statement of the basis for reducing the notification period.” 29 U.S.C. §2102(b)(3).

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