Published on *The National Law Review* https://natlawreview.com

Private Equity Firms Face Potential Liability Under Plant Closing Laws

Article By:

McDermott Will & Emery

The federal **Worker Adjustment and Retraining Notification Act** (WARN) requires an employer with 100 or more employees to provide 60 days' advance notice of a "**mass layoff**" or "**plant closing**," as defined in the statute, unless an exception is applicable. Several states have comparable laws that typically are triggered at a lower threshold of employment losses. Failure to provide the 60-day notice often results in **class action litigation** and potential liability for the pay and benefits that the affected employees would have received if the employer had given proper notice. Private equity firms and their holding companies and advisory firms often are drawn into the litigation based on allegations that, whether as a parent entity or a lender, they are liable along with the (frequently bankrupt) portfolio company. Avoiding such litigation and exiting quickly from litigation that could not be avoided will depend on the degree to which the private equity participants proactively manage their activities in light of the criteria the courts use to assess their potential liability.

For example, in December 2013, the U.S. Court of Appeals for the Second Circuit (with jurisdiction over New York, Connecticut and Vermont) ruled in *Guippone v. BH S&B Holdings LLC* that a private equity firm or its holding company may be liable to a class of employees for the failure of its portfolio company to comply with the WARN law. Essentially, Steve & Barry's was a chain of retail apparel stores owned and operated by Steve & Barry's Industries, Inc. (S&B Industries), the assets of which were purchased by BH S&B Holdings LLC (Holdings), which was wholly owned by BHY S&B Holdco, LLC (HoldCo), a holding company, which in turn was owned by various private equity investment firms. Holdings, the operating company that employed the employees, lacked a board of directors of its own, and the officers of Holdings included representatives from the private equity firms. After Holdings' lender exercised its rights under its loan agreement and "swept" roughly $30 million from Holdings' account, the Holdco board passed a resolution authorizing Holdings to file for bankruptcy protection. It did, quickly followed by store closings and employee terminations. The trial court dismissed the private equity firms at the pleading stage, but denied HoldCo's motion to dismiss. After discovery, the trial court granted HoldCo's motion for summary judgment on the basis that there were not sufficient facts to permit a jury to conclude that HoldCo was a single employer with Holdings.

However, while the appellate court affirmed the dismissal of the private equity defendants at the pleading stage because of insufficient factual allegations, the appellate court reversed the ruling in

favor of Holdco and remanded the case for a trial to determine whether HoldCo was a single employer with Holdings. On the latter issue, the court declined to apply the test for determining whether a lender or creditor is responsible for its debtors WARN violation (*i.e*., whether the creditor was responsible for operating the business as a going concern rather than acting only to protect its security interest and preserve the business asset for liquidation or sale). Instead, the court joined a growing consensus that the proper test for whether a related or parent entity (or, as in this case, an equity investor) can be considered an employer under WARN is the "five non-exclusive factors set forth in Department of Labor regulations" (*i.e.,* 20 C.F.R. §639.3(a)(2)):

Under existing legal rules, independent contractors and subsidiaries which are wholly or partially owned by a parent company are treated as separate employers or as a part of the parent or contracting company depending upon the degree of their independence from the parent. Some of the factors to be considered in making this determination are (i) common ownership, (ii) common directors and/or officers, (iii) de facto exercise of control, (iv) unity of personnel policies emanating from a common source, and (v) the dependency of operations.

No single factor controls, and all factors need not be present—the courts balance these and any other particularly relevant factors in deciding whether the nominally separate entities actually functioned as a single entity with regard to the policy of whether to terminate the employees. The presence of the first two factors (common ownership and common directors and/or officers) is not controlling. The second factor (whether the two entities have the same people occupying director, offer positions at both entities, repeatedly transfer management personnel between the entities, or have officers or directors occupying formal management positions regarding the second entity) is of minimal importance because courts generally presume that they are wearing the appropriate subsidiary hat when acting for the subsidiary.

The third factor (de facto control) is the most critical factor and focuses beyond the issue of whether the parent merely exercised control pursuant to the ordinary incidents of stock ownership and, instead, on whether the affiliated company or private equity firm was the decision maker responsible for the employment practice giving rise to the litigation—the plant closing or mass layoff. The fourth factor focuses on whether the parties have centralized control of labor relations, such as centralized hiring and firing, payment of wages, maintenance of personnel records, benefits, and participation in collective bargaining. Finally, the fifth factor examines whether the entities share administrative or purchasing services or interchange employees, equipment or commingled finances, beyond mere reporting by the subsidiary's officers to the parent, pursuant to a chain of command.

In *Guippone*, the appellate court sent the case back for a jury trial because the plaintiff had shown that a fact question on single-employer status existed. Holdings lacked a board, and one of HoldCo's directors admitted that he did not know the distinction between Holdings and HoldCo. HoldCo's board chose Holdings' management and negotiated its financing. The record could permit a jury to conclude that Holdings lacked the ability to make any decision independently and that the HoldCo board resolution authorizing Holdings to effectuate the reductions in force was, in fact, the direction from HoldCo to Holdings to undertake the layoffs.

This and similar cases demonstrate the importance of observing corporate formalities, establishing and filling the director and officer positions of all entities, permitting the operating company management to make the decisions regarding employment terminations and plant closings, and clearly communicating and documenting these activities.

National Law Review, Volume IV, Number 104