Employer's Failure to Issue WARN Notification
Excused Due to Abrupt Termination of Financing

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Despite the increasing prominence of pre-packaged or pre-negotiated chapter 11 cases in recent years, not every bankruptcy filing by or against a company is a carefully planned event orchestrated over a period of months or even years to achieve a workable reorganization, sale, or liquidation strategy. Sometimes, unanticipated circumstances precipitate a bankruptcy filing. If the debtor employs a substantial workforce that is dismissed (pre- or post-bankruptcy) because the debtor either ceases operating or significantly reduces the number of its employees, state and/or federal law other than the Bankruptcy Code may impose obligations on the debtor in connection with the workforce dismissals or plant closures.

A recent unpublished ruling by the Fifth Circuit Court of Appeals examines a debtor-employer's responsibilities under the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 *et seq.* ("WARN"). In *Angles v. Flexible Flyer Liquidating Trust (In re Flexible Flyer Liquidating Trust)*, 2013 BL 35609 (5th Cir. Feb. 11, 2013), the court affirmed a bankruptcy court determination that a debtor-employer was not required to give a 60-day WARN notification to its employees because a sudden, unanticipated termination of financing which forced the company to file for bankruptcy protection satisfied WARN's notification exception for "unforeseeable business circumstances."

WARN

Enacted in 1988, WARN protects workers, their families, and communities by requiring most employers with 100 or more employees to provide notification 60 calendar days in advance of plant closings and mass layoffs. Twenty-nine U.S.C. § 2102(a) provides that:

> [a]n employer shall not order a plant closing or mass layoff until the end of a 60-day period after the employer serves written notice of such an order –
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> (1) to each representative of the affected employees as of the time of the notice or, if there is no such representative at that time, to each affected employee.

Twenty-nine U.S.C. § 2101(a)(2) defines "plant closing" as:

> the permanent or temporary shutdown of a single site of employment, or one or more facilities or operating units within a single site of employment, if the shutdown results in an employment loss at the single site of employment during any 30-day period for 50 or more employees excluding any part-time employees.

"Mass layoff" is defined in 29 U.S.C. § 2101(a)(3) as a reduction in the workforce that is not the result of a plant closing and results in an employment loss at a single site of employment during any 30-day period of a specified percentage or aggregate number of employees.

Twenty-nine U.S.C. § 2101(a)(1) defines "employer" as "any business enterprise that employs – (A) 100 or more employees, excluding part-time employees; or (B) 100 or more employees who in the aggregate work at least 4,000 hours per week (exclusive of hours of overtime)." However, a court-fashioned "liquidating fiduciary" exception provides that a liquidating fiduciary in a bankruptcy case (e.g., a trustee or other estate representative) does not fit the definition of an employer for purposes of WARN. *See 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 (3d Cir. 1999); *Conn v. Dewey & LeBoeuf LLP (In re Dewey & LeBoeuf LLP)*, 2013 BL 39061 (Bankr. S.D.N.Y. Feb. 13, 2013).

The U.S. Department of Labor has prescribed regulations to implement WARN. Among other things, the regulations prescribe when an employer must give WARN notice, who the employer must notify, how the employer must give notice, and what information the notice must contain. *See* 20 C.F.R. § 639 *et seq*.

Twenty-nine U.S.C. § 2104(a) provides that an employer who fails to give WARN notice shall be liable to each aggrieved employee who suffers an employment loss as a result of such plant closing or mass layoff for, among other things, back pay for each day during the period of the violation. It also states that the employer's liability "shall be calculated for the period of the violation, up to a maximum of 60 days, but in no event for more than one-half the number of days the employee was employed by the employer."

However, if an employer can prove that it shut down operations because either it was a "faltering company" or the shutdown was due to business circumstances "that were not reasonably foreseeable," it need not comply with WARN's 60-day notice provisions. Twenty-nine U.S.C. § 2102(b) provides as follows:

> (1) An employer may order the shutdown of a single site of employment before the conclusion of the 60-day period if as of the time that notice would have been required the employer was actively seeking capital or business which, if obtained, would have enabled the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business.
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> (2)(A) An employer may order a plant closing or mass layoff before the conclusion of the 60-day period 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.

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In addition, 29 U.S.C. § 2102(b)(2)(B) provides that "[n]o notice under [WARN] shall be required if the plant closing or mass layoff is due to any form of natural disaster, such as a flood, earthquake, or the drought currently ravaging the farmlands of the United States."

Even if the exceptions in 29 U.S.C. § 2102(b)(1) and (b)(2)(A) apply, an employer is not relieved of its obligation to notify employees altogether. When an employer ceases operating due to "not reasonably foreseeable" business circumstances or because it is a "faltering company," the employer can give less than 60 days' WARN notice, provided the notice contains certain "basic" information (*see* 20 C.F.R. § 639.7) and the reasons the employer could not provide the full 60 days' notice. *See* 29 U.S.C. § 2102(b)(3).

Twenty C.F.R. § 639.9(b)(1) states that closings and layoffs are not foreseeable when "caused by some sudden, dramatic, and unexpected action or condition outside the employer's control." The regulations also provide that, in assessing the foreseeability of business circumstances, the focus should be "on an employer's business judgment" and that an employer is required only to "exercise such commercially reasonable business judgment as would a similarly situated employer in predicting the demands of its particular market." *See* 20 C.F.R. § 639.9(b)(2).

Some states have enacted laws similar to WARN that impose enhanced employee-notification requirements. *See*, *e.g.*, New York State Worker Adjustment and Retraining Notification Act, N.Y. LAB. L. §§ 860−860-i; art. 25-A, pt. 921 (2009); CAL. LAB. CODE § 1400−1408 (2003), 820 ILL. COMP. STAT. 65/*et seq.* (2005).

The Fifth Circuit addressed the unforeseeable-business-circumstances exception to the federal WARN notification requirement in *Flexible Flyer*.

Flexible Flyer

Private-equity fund Cerberus Capital Management Corp. ("Cerberus") formed FF Acquisition Corp., d.b.a. Flexible-Flyer ("Flexible Flyer") in 1997 to purchase the Flexible Flyer assets out of bankruptcy. At the time, Flexible Flyer manufactured swing sets, hobby horses, go-carts, utility vehicles, and fitness equipment, in addition to the iconic Flexible Flyer sled, sold by a variety of retailers, including Walmart, Toys "R" Us, Kmart, and Sam's Club.

Flexible Flyer never made a profit and constantly lost money. It was funded almost entirely by Cerberus, which infused Flexible Flyer with $85 million in capital. However, late in 2000, the company entered into a factoring arrangement with CIT Group Commercial Systems, LLC ("CIT"). Under the factoring agreement, CIT advanced funds equal to 80 percent of Flexible Flyer's receivables.

Each year, Cerberus informed Flexible Flyer that it would shut down the company if it did not become profitable within the coming year, but Cerberus never made good on the threat and continued to provide Flexible Flyer with capital. In 2005, Flexible Flyer experienced several financial reverses, including a product recall due to defective parts. The company notified its employees in April 2005 of possible layoffs in the affected division. Retailers also informed Flexible Flyer that they would be deferring purchases of millions of dollars' worth of products.

Management took steps to triage the damage and remained optimistic that the company could weather the storm, especially in light of a bankruptcy filing by Flexible Flyer's primary competitor in the U.S. swing-set market. In August 2005, Flexible Flyer consulted professionals to explore a range of options, including divestiture of unprofitable divisions and a bankruptcy filing.

Soon afterward, CIT reduced its credit line by cutting advances to 50 percent of receivables. Two weeks later, CIT informed Flexible Flyer that it would cease advancing credit altogether. After Cerberus refused a request for additional capital, Flexible Flyer filed for chapter 11 protection in Mississippi on September 9, 2005. That same day, the company informed its employees (by means of an abridged WARN notification) that it would be terminating business operations, resulting in company-wide layoffs. Shortly afterward, Flexible Flyer sold substantially all of its assets, including the Flexible Flyer® trademark.

A group of more than 100 former employees filed an adversary proceeding in the bankruptcy court alleging that Flexible Flyer was liable under WARN for failing to give them the required 60-day layoff notice. The bankruptcy court ultimately determined that Flexible Flyer was excused from providing advance notice because it had demonstrated that the layoffs were the result of an unforeseeable business circumstance. The court also found that, under the circumstances, Flexible Flyer had provided WARN notification to its employees "at the earliest practical date that such a notice could be provided." The district court affirmed the ruling on appeal.

The Fifth Circuit's Ruling

A three-judge panel of the Fifth Circuit affirmed the rulings below in an unpublished decision. Focusing on the foreseeability issue, the court explained that "where it only is possible that the business circumstance at issue may occur, such circumstances are not reasonably foreseeable." Rather, the court wrote, "it is the probability of occurrence that makes a business circumstance 'reasonably foreseeable' and thereby forecloses use of the [unforeseeable business circumstances] exception."

The Fifth Circuit did not fault the bankruptcy court's conclusion that the closing of Flexible Flyer's business was not reasonably foreseeable. All of the evidence, the Fifth Circuit stated, "shows that the focus of Flexible Flyer's management was on saving the company, not planning for an upcoming shutdown." The court also determined that the bankruptcy court committed no clear error in concluding that management's exercise of its business judgment to keep Flexible Flyer operating and its expectation that it would continue operations into the following year were "completely reasonable," despite the fact that "Flexible Flyer's financial condition was perilous for much of its eight-year existence." According to the Fifth Circuit, "[i]t was only when CIT and Cerberus both decided to cut off funding completely, and did so almost simultaneously without warning, that the shutdown became inevitable."

In affirming the rulings below, the Fifth Circuit observed that the case before it presented a "convincing example" of an event satisfying the unforeseeable-business-circumstances exception, consistent with the underlying purpose of WARN:

> [WARN] allows good faith, well-grounded hope, and reasonable expectations. Its regulations protect the employer's exercise of business judgment and are intended to encourage employers to

> take all reasonable actions to preserve the company and the jobs. Holding Flexible Flyer liable for a [WARN] violation on the facts found by the bankruptcy court would serve only to encourage employers to abandon companies even when there is some probability of some success.

Outlook

In certain respects, *Flexible Flyer* is a cautionary tale. Employers confronting problems that may lead to workforce reductions, mass layoffs, or the shuttering of a business altogether should be aware of their obligations under WARN and comparable state laws. If WARN notification, even in an abridged form, is not possible due to unforeseen circumstances, management should be prepared to demonstrate not only that the events in question were unanticipated, but also that business decisions made during the period leading up to a plant closure or mass layoff were reasonable under the circumstances. According to the Fifth Circuit's analysis, the probability, rather than the possibility, of the occurrence of the business circumstance that forces the shutdown is the determinative factor.

Interestingly, although the bankruptcy court in *Flexible Flyer* also ruled that the company satisfied the "faltering company" exception in 29 U.S.C. § 2102(b)(1), the Fifth Circuit never reached the issue on appeal. Explaining that the bankruptcy court found the unforeseeable-business-circumstances exception to be "by far the most compelling," the court of appeals declined to express any views on this alternative exception to the WARN notification requirements.

The debtor in *Flexible Flyer* may also have been exempt from the 60-day WARN notification requirement as a liquidating fiduciary, especially given that the company never attempted to

reorganize in chapter 11 instead of shutting down immediately upon the bankruptcy filing. However, the issue was apparently never raised in either the bankruptcy or appellate courts.