CLIENT UPDATE

DELAWARE COURT AFFIRMS REFUSAL TO EXTEND WARN ACT LIABILITY TO PRIVATE EQUITY SPONSOR

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On September 29, 2014, the United States District Court for the District of Delaware affirmed an earlier decision of the Delaware Bankruptcy Court in *In re Jevic Holding Corp*.[1] holding that a private equity sponsor was not liable for its portfolio company's alleged violations of the WARN Act. The District Court ruling is good news for private equity funds and other investors with portfolio companies in distress. At the same time, it is also a useful reminder of the importance of taking appropriate precautions to avoid "single employer" liability under the WARN Act – in particular by observing corporate formalities and exercising decision-making authority through the portfolio company's board of directors rather than directly.

BACKGROUND

In 2006, a wholly owned subsidiary of Sun Capital Partners, Inc. ("SunCap") acquired Jevic Transportation, Inc. ("Jevic"), a trucking company, in a leveraged buyout. At that time, Jevic and SunCap entered into a management services agreement under which SunCap provided specified consulting services to Jevic in exchange for compensation. On May 20, 2008, Jevic and certain of its affiliates

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[1] *In re Jevic Holding Corp.*, 492 B.R. 416 (Bankr. D. Del. 2013). Our Client Update dated May 16, 2013, "Holding the Defensive Line: Delaware Court Rejects Extension of WARN Act Liability to Private Equity Sponsor," described the Bankruptcy Court's ruling.

filed for chapter 11 protection. Just one day earlier, Jevic had sent its employees termination notices pursuant to the WARN Act. Subsequently, a class of terminated Jevic employees sued both Jevic and SunCap, alleging violations of the federal and New Jersey WARN Acts for failing to provide the terminated employees with the requisite 60-day notice before a plant closing or mass layoff.

On May 10, 2013, Bankruptcy Judge Brendan L. Shannon ruled that SunCap and Jevic did not constitute a "single employer" under the WARN Act and thus SunCap was not ultimately liable for the employee layoffs. The terminated employees appealed.

THE WARN ACT AND "SINGLE EMPLOYER" LIABILITY

The WARN Act requires certain employers to provide eligible employees with 60 days' advance notice of plant closings or mass layoffs. Covered employers that fail to provide the requisite notice of termination may be liable for lost wages, benefits and other penalties.

In deciding whether the direct employer and a related entity, such as a parent company, are a "single employer" for purposes of WARN Act liability, the Third Circuit considers five factors: (1) common ownership, (2) common directors and/or officers, (3) *de facto* exercise of control, (4) unity of personnel policies emanating from a common source and (5) dependency of operations. Applying the five-factor test to the *Jevic* case, the Bankruptcy Court found that the first two factors weighed in favor of plaintiffs, whereas the remaining three factors favored SunCap. The District Court agreed.

THE DISTRICT COURT DECISION

As the direct parent of Jevic with two of its own representatives on Jevic's board of directors, SunCap did not contest the Bankruptcy Court's finding that the first two factors, common ownership and common directors and/or officers, were satisfied.

Addressing the third factor, the District Court affirmed Judge Shannon's ruling that SunCap did not exercise *de facto* control over Jevic. Even though SunCap maintained certain indicia of control, ultimately, it was Jevic's decision to shut down the company and terminate its employees. Importantly, the District Court cautioned that mere "exercise of control pursuant to the ordinary incidents of stock ownership" is not enough to support *de facto* control. Rather, the relevant question is "whether one company was the decision-maker responsible for the employment practice giving rise to the litigation." The appellants argued that SunCap's decision not to provide funding was a direct cause of Jevic's closure, but the District Court rejected this "natural and probable consequences"

approach, noting that Jevic made the ultimate decision – in consultation with independent professionals and turnaround consultants – to shut down.

Turning to the fourth factor, unity of personnel policies, the District Court decided that SunCap and Jevic did not "actually function[] as a single entity with regard to its relationships with employees." While SunCap and Jevic had cooperated with respect to certain limited employee benefit initiatives, the District Court found that these programs on their own were not sufficient to satisfy the test. "Ultimately, appellants failed to produce evidence that appellee **directly** hired or fired Jevic employees, paid the salaries of Jevic employees or shared a personnel or benefits recordkeeping system with Jevic," the Court concluded.

The District Court also rejected the appellants' argument that the fifth factor, dependency of operations, was satisfied. This factor, the Court observed, "cannot be established by the parent corporation's exercise of its ordinary powers of ownership." The appellants argued that SunCap exceeded its ordinary powers of ownership by implementing a restructuring plan and putting in place a management services agreement. In response, SunCap pointed out that its influence over Jevic's restructuring was constrained by the terms of a consulting agreement developed by an independent consultant pursuant to which Jevic retained final decision-making authority. Furthermore, the management services agreement explicitly delegated control of Jevic's activities to its board of directors and officers.

IMPLICATIONS

Like the Bankruptcy Court's earlier ruling, the District Court's decision is good news for investors in troubled companies. However, WARN Act claimants will likely continue to assert "single employer" claims against shareholders with deep pockets. To protect themselves from liability, private equity funds and other investors should be careful to observe corporate formalities, exercising decision-making authority through the portfolio company's board of directors rather than directly, and to hire and seek the advice of independent advisors that report to the portfolio company's board of directors and management.

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Please do not hesitate to contact us with any questions.

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