

WARN ACT LIABILITY AND ENTREPRENEURIAL COMPANIES

Recent court decisions involving Carolinas employers have broadened potential liability exposure for venture capital and private equity firms involved with entrepreneurial companies. Specifically, the recent decisions have expanded scenarios in which venture capital and private equity firms may be considered “joint employers” with the companies in which they make equity investments. As a result, the equity investors may be liable under the Worker Adjustment and Retraining Notification (“WARN”) Act and other employment laws to employees of their portfolio companies.

WARN Act Overview

The WARN Act generally comes into play when there is a “plant closing” or a “mass layoff.”

- A plant closing means 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” for 50 or more employees (as all those terms are defined by the Act), during a 30-day or 90-day period.
- A mass layoff means a layoff that does not involve a plant closing and results in an employment loss at a single site of employment, during a 30-day or 90-day period, for: (1) 50 or more employees if they constitute 33 percent or more of active employees, or (2) 500 employees regardless of whether they constitute 33 percent of the workforce.

If the WARN Act applies, the employer must give 60 days notice of the plant closing or mass layoff to affected employees, the state employment security commission, and certain local government officials. Notices must contain information required by the Act.

The WARN Act provides exceptions for closing temporary facilities, “faltering companies,” “unforeseeable business circumstances,” natural disasters, and sales of businesses, among others. If an exception applies, the 60-day notice requirement may be wholly or partially waived. The employer bears the burden of proving that an exception applies.

WARN Act violations can lead to civil penalties, including back pay and lost benefits for up to 60 days, and attorney’s fees, as well as fines of up to \$500 per day for each day of violation for up to 60 days.

The Outboard Marine Case

Vogt v. Greenmarine Holding, LLC involved Outboard Marine Corporation ("OMC"), a South Carolina company that filed for Chapter 11 bankruptcy, closed its 13 facilities, and fired most of its 6,500 employees, without complying with the WARN Act.

The employees filed a lawsuit against two groups of investment companies: (1) Greenmarine Holding LLC and two other investment companies that together owned or controlled OMC's stock (the "Direct Owners"), and (2) five other investment companies that owned interests in the three Direct Owners.

The suit claimed the investment companies and OMC acted as "joint employers" for purposes of WARN because the financial and management decisions—and, ultimately, the decision to shut down—were made by the investment companies. The companies moved to dismiss, arguing they were merely investors in OMC and not employers.

The district court denied the motion to dismiss as to the Direct Owners, finding that the employees "alleged facts about defendants' corporate structure and the decision to shut down [OMC's] plants and effect mass layoffs which, if true, would entitle them to relief against [the Direct Owners] under WARN." (The court dismissed the claims against the other five investment companies.)

In reaching its holding as to the Direct Owners, the district court concluded "that the appropriate test for inter-corporate WARN liability is the five-factor" test set out in the U.S. Department of Labor's ("DOL") WARN Act regulations. The DOL regulations explain the five-factor test as follows:

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.

Applying the five-factor test, the district court emphasized that the Direct Owners allegedly had de facto control over the decision to file bankruptcy and to lay off the OMC employees. The court found it significant that, according to the complaint, two of the Direct Owners:

- Hired OMC's CEO and signed the CEO's contract;
- Prepared and participated in the resolution that OMC file bankruptcy;
- Entered into an agreement with the CEO to have the CEO coordinate OMC's bankruptcy filing, and
- Were present at the telephone meeting at which the bankruptcy and plant closing were discussed.

The third Direct Owner, it was alleged, made the decision that resulted in the plant closing, and its management committee was identical to OMC's board of directors.

These allegations, according to the court, were enough to state a valid WARN claim against the three Direct Owners.

The Shelby Yarn Case

In *In re Shelby Yarn Co./Sigmon v. Recovery Equity Investor, L.P.*, Shelby Yarn Company closed its Shelby, North Carolina, plants, laying off 650 employees without complying with the WARN Act.

In response, Shelby Yarn's Chapter 7 trustee brought an adversary proceeding in district court against, among other defendants, Recovery Equity Investors II, L.P. ("REI II"), an investment fund that was the sole shareholder of Shelby Yarn; Recovery Equity Partners II, L.P. ("REP II"), an investment fund that was the sole general partner of REI II; two individuals who were the sole general partners of REP II, Jeffrey Lipkin and Joseph Finn-Egan; and two related investment funds (collectively, the "REI Defendants").

The Chapter 7 trustee sought to recover damages from the REI Defendants under the WARN Act, the North Carolina Wage and Hour Act, COBRA, and ERISA. The REI Defendants moved for summary judgment, arguing they could not be held liable as "employers" under those statutes.

Analyzing the REI Defendants' motion for summary judgment, the district court applied the DOL's five-factor test, focusing on the de facto control issue. The court concluded that "[t]here is no question that by December 1999, and probably before, REI II had de facto control over Shelby Yarn" because "Lipkin and Finn-Egan were intricately involved in every decision affecting the company." The court listed various actions taken and decisions made by Lipkin and/or Finn-Egan, such as:

- Deciding to take responsibility for Shelby Yarn's predecessor entity's unpaid health insurance claims;
- Chastising Shelby Yarn's management and being "intricately involved in decisions relating to competition, new products lines, and patents, etc.";
- Having authority to approve an employee bonus and pressing the Shelby Yarn CEO to hire a potential CEO replacement; and
- Insisting on more board of director meetings when the Shelby Yarn CEO wanted less.

Based on these allegations, the district court concluded that the REI Defendants could be liable to the employees as "employers."

Conclusion

The rulings in the Outboard Marine and Shelby Yarn cases directly impact investors and could expose lenders or an employer's parent or sister companies to expensive WARN Act claims if they exercise operational control over the employer or get involved in its personnel decisions. As a result, prudent investors should—in conjunction with consulting corporate and employment counsel—consider avoiding conduct that may give the appearance that they are exercising operational control over portfolio companies. In addition, employers should make sure that in the event a layoff becomes necessary, the requirements of the WARN Act are met.

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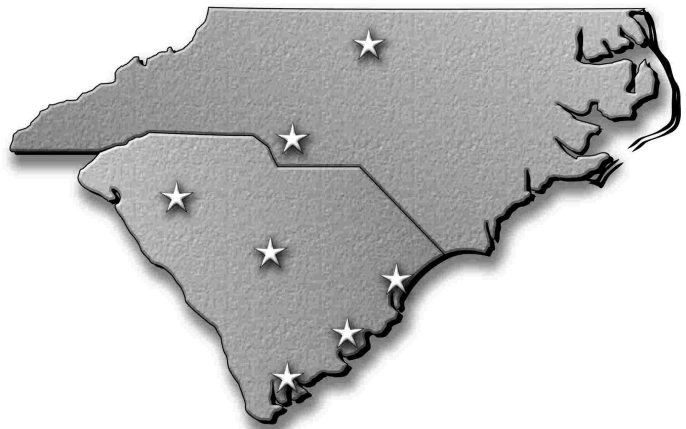
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