The Case Against The Liquidating Fiduciary Exception to Liability Under WARN Act (Why the Third Circuit Got it Wrong in *United Healthcare* And Why it Should Never Be Applied in Chapter 11 Cases)

Written by:
Kathryn E. Perkins
Klehr Harrison Harvey Branzburg, LLP; Philadelphia, PA
kperkins@klehr.com

I. The Intersection of the WARN Act and the Bankruptcy Code

The Worker Adjustment and Retraining Notification Act (WARN Act), 29 USC §§2101 *et seq.*, provides protection to workers, their families, and communities by requiring employers to provide notification sixty calendar days in advance of plant closings and mass layoffs. Advance notice provides workers and their families some transition time to adjust to the prospective loss of employment, to seek and obtain alternative jobs and, if necessary, to enter skill training or retraining that will allow these workers to successfully compete in the job market. The WARN Act also provides for notice to state dislocated worker units so that dislocated worker assistance can be promptly provided.[1]

The WARN Act is silent with regard to the impact of a bankruptcy proceeding on WARN Act liability. The WARN Act's legislative history is also largely devoid of commentary regarding the intersection of the WARN Act and the Bankruptcy Code. In fact, during the Congressional debates leading up to the enactment of the WARN Act, the legislature's only discussion of the Act's intersection with the Bankruptcy Code were comments suggesting the enactment of WARN would result in an increased number of bankruptcies caused by the pre-

[1] 20 C.F.R. §639.1.

notification procedures which had the potential of scaring an employer's customers and suppliers and increasing the likelihood of an employer filing for bankruptcy.[2]

Although the sources traditionally relied on by courts to aid in statutory interpretation are silent as to the impact of bankruptcy on WARN Act liability, the Third Circuit held in *Official Comm. of Unsecured Creditors of United Healthcare Sys. v. Medical Staff, Local 1199J, (In re United Healthcare)*[3], that a bankrupt employer does not fall within the definition of an "employer" as that term is defined under the WARN Act creating the liquidating fiduciary exception which many DIPs claim insulates them from WARN Act liability. As one bankruptcy court noted in dicta, if the liquidating fiduciary exception is adopted and applied, it would literally "swallow" and "eviscerate the WARN Act."[4]

In recognizing the liquidating fiduciary exception, the Third Circuit relied on the Department of Labor's preamble to the final rule, however, that reliance was misplaced and unwarranted under the canons of statutory construction and should not be followed by future courts.

II. The Third Circuit's Creation of the Liquidating Fiduciary Exception was Inconsistent with The Rules of Statutory Construction and Should not be Followed.

Canons of statutory construction dictate that courts should not read into remedial statutes exceptions not explicitly set forth in those statutes.[5] Because the WARN Act constitutes remedial legislation, any exception to liability under it should be narrowly construed.[6] The initial step in all cases involving statutory interpretation, must be the language employed by

[2] Bartell, L., "*Why Warn? The Worker Adjustment and Retraining Notification Act in Bankruptcy*," 18 Bankr. Dev. J. 243 (2002) (citing 131 Cong. Rec. H31, 399 (Nov. 12, 1985) (statement of Rep. Jeffords)).
[3] 200 F.3d 170, 177 (3d Cir. 1999)
[4] *Law v. American Capital Strategies, Ltd.*, 2007 W.L. 221671 at * 17 (M.D. Tenn. Jan. 26, 2007).
[5] *Zimmerman v. Cambridge Credit Counseling Corp.*, 409 F.3d 473, 476 (1st Cir. 2005)(citing *Hogar Agua Y. Vida En El Desierto, Inc. v. Suarez-Medina*, 36 F.3d 177, 182 (1st Cir. 1994)).
[6] *Local Union 7107, UMW v. Clinchfield Coal Co.*, 124 F.3d 639, 640-41 (4th Cir. 1997); *accord Beach f. JD Lumber, Inc.*, No. CV-08-416, 2010 U.S. Dist. LEXIS 88397, at *7 (D. Idaho Aug. 24, 2010) (finding that exceptions to the WARN act should be "construed narrowly so as not to eviscerate the real purpose of the Act.").

Congress, and it is only when a literal application of a statute would be absurd that a court should look beyond the legislature's words. Accordingly, prior to creating the liquidating fiduciary exception to the defined term "employer" the Third Circuit should have first concluded that such an exception was warranted by the statutory definition of the term employer. The WARN Act defines the term "employer" in Title 29 § 2101 as:

> (1) the term "employer" means 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);

There is nothing absurd about applying the definition of employer to a debtor-in-possession, accordingly, the Third Circuit erred when it went beyond the text of the statute to create the liquidating fiduciary exception.

Even assuming the statute's use of undefined term "business enterprise" made the statute ambiguous, a review of the Congressional record reflects absolutely no intention on the part of Congress to exclude bankrupt entities from the scope of a "business enterprise." In fact, the Congressional Record reflects the use of the term "business enterprise" was merely to ensure that all types of business entities fell within the rule, i.e., that the WARN Act covered not only corporations but also limited liability companies, limited partnerships, etc. As one district court examining legislative record regarding the origins of the terms "business entity" and "employer" noted:

> the Senate-House Conference Report which accompanied the WARN legislation stated as follows:
>
> "'Employer'. The Conference Agreement retains the Senate Amendment language that the term 'employer' means a business enterprise. The Conferees intend that a 'business enterprise' be deemed synonymous with the terms company, firm or business,

> and that it consist of one or more sites of employment under common ownership or control. For example, General Motors has dozens of automobile plants throughout the country. Each plant would be considered a site of employment, but as provided in the bill, there is only one 'employer' - General Motors." (House Conf. Rep. No. 100-576, 100th Cong., 2nd Sess., 1045, 1046 [reprinted in 5 U.S. Code Cong. & Admin. News [1988], 2078, 2079] [emphasis supplied]).
>
> In the Court's view, the statute, regulations and legislative history indicate that Congress defined "employer" as a "business enterprise" and intended a "business enterprise" to mean a corporate entity -- i.e. corporation, limited partnership, or partnership -- not an individual. … The legislative history explicitly supports this view of the law (see House Conf. Rep. No. 100-576, supra ["the Conferees intended that a 'business enterprise' be deemed synonymous with the terms company, firm or business"]); the statute, by defining "employer" as "any business enterprise that employs - 100 or more employees," implicitly supports this view, since it is the rare individual who employs "100 or more employees" without resort to any type of corporate form. (See also Webster's Third International Dictionary [1976], p.757 [defining "enterprise" as "a unit of economic organization or activity (as a factory, a farm, a mine); esp: a business organization: FIRM, COMPANY"]).[7]

Simply put, there is nothing in the legislative history supporting a finding that the term "business enterprise" was intended to exclude anything other than individuals, i.e. it was never intended by Congress to exclude bankrupt entities.

A second canon of statutory construction also weighs against recognizing an implicit exception to WARN Act liability for bankrupt employers. Specifically, "Congress is presumed to enact legislation with knowledge of the law and a newly-enacted statute is presumed to be harmonious with existing law and judicial concepts."[8] Based on this canon, it can be presumed that when Congress enacted the WARN Act, and specifically when Congress crafted the definition of employer, Congress was aware of the bankruptcy code, and aware of the fact that

[7] *Cruz v. Robert Abbey, Inc.*, 778 F. Supp. 605, 609 (E.D.N.Y. 1991).
[8] *Prime Care of Northeast Kan., LLC v. Humana Ins. Co.*, 446 F.3d 1284, 1287 (10th Cir. 2006) (citing *Garcia v. Dep't of Homeland Sec.*, 437 F.3d 1322, 1336 (Fed. Cir. 2006)).

many employers who conducted mass layoffs were likely to be experiencing financial difficulties. Accordingly, if Congress wanted to exclude bankrupt entities from the scope of the term "employer" it could easily have done so. As such, courts should avoid acting as legislators resist the temptation to essentially rewrite the definition of employer to exclude bankrupt employers.[9]

In sum, courts should not further compound the Third Circuit's error by recognizing an exception to WARN Act liability for entities who are not specifically statutorily excluded from liability because such an exception is unwarranted under canons of statutory construction.

A. The Third Circuit's Deference to and Reliance on the Preamble to the Department of Labor's Final Rule was Unwarranted

The WARN Act authorizes the Secretary of Labor to "prescribe such regulations as may be necessary to carry out [the] Act."[10] Accordingly, the Department of Labor, in anticipation of the promulgation of a final rule, published for comment several notices, a discussion paper, an interim interruptive rule and a proposed rule on the WARN Act in the Federal Register (collectively the "Notice and Comment Documents").[11] Although the Notice and Comment Documents solicited feedback relating to the proposed definition of the term "employer" none of these documents addressed an exception for bankrupt employers. It was not until the issuance of the Final Rule on April 20, 1989 that the Department of Labor addressed for the first time the impact of bankruptcy on an employer's WARN Act liability stating:

> [the] DOL agrees that a fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit

[9] *See Borgenicht v. Creditors' Committee,* 479 F.2d 150, 153 (2d Cir. 1973) (noting that when Congress chose not to draft a statute a certain way the "court cannot rewrite the statute by extending it beyond the thought conveyed by the unambiguous words"); *see also Artuz v. Bennett,* 531 U.S. 4, 10, 148 L. Ed. 2d 213, 121 S. Ct. 361 (2000) ("Whatever merits these and other policy arguments may have, it is not the province of this Court to rewrite the statute to accommodate them.").

[10] 29 U.S.C. § 2107(a).

[11] *See* 53 F.R. 34884 (Sept. 8, 1988); 53 F.R. 36056 (Sept. 16, 1988); 53 F.R. 38026 (Sept. 29, 1988); 53 F.R. 39403 (Oct. 6, 1988); 53 F.R. 43731 (Oct. 28, 1988); 53 F.R. 4884 (Dec. 2, 1988); and 53 F.R. 49076.

> of creditors does not succeed to the notice obligations of the *former employer* because the fiduciary is not operating a "business enterprise" in the normal commercial sense. In other situations, where the fiduciary may continue to operate the business for the benefit of creditors, the fiduciary would succeed to the WARN obligations of the employer precisely because the fiduciary continues the business operation.[12]

Again, this language was not subject to review and comment, but rather appeared for the first time in the final version of the preamble to the final rule. Thus, because the language from which the exception derived was not entitled to review and comment, it is not entitled to the level of deference the Third Circuit accorded it, and future courts should not be so quick to rely on these statements.

III. The Liquidating Fiduciary Exception by its Terms Should Not Apply to a DIP Because the DIP is not a "Former Employer"

The preamble language from which the Third Circuit derived the Liquidating Fiduciary Exception should not, by its own terms, be applicable to a DIP. The language giving rise to the liquidating fiduciary exception provides that such a fiduciary "does not succeed to the notice obligations of the former employer." Put another way, application of the exception is contingent on the premise that there exists a "former employer," however, the commencement of a chapter 11 does not create a new or distinct employer separate and apart from the pre-petition employer. To the contrary, the Bankruptcy Code makes clear that the chapter 11 debtor is the same entity as the pre-petition debtor. This concept was best summarized by the Ninth Circuit who held:

> [t]he bankruptcy code defines a chapter 11 debtor in possession as the debtor. 11 U.S.C. § 1011(1). The debtor, in turn, is defined as the "person or municipality concerning which a case under this title has been commenced." 11 U.S.C. § 101 (13). Bankruptcy cases can be filed only with respect to pre-bankruptcy persons. *Cf.* 11 U.S.C. § 101(persons includes corporate entities). Thus the debtor in possession is the debtor, and the debtor is the person… that filed for bankruptcy. Applying these statutory provisions

[12] 54 Fed. Reg. 16,042 (codified at 20 C.F.R. 639 (2011)(emphasis added)).

> literally,… the debtor in possession is the same person for bankruptcy purposes as… the pre-bankruptcy corporation.[13]

The Ninth Circuit went on to note that its analysis was consistent with Supreme Court's earlier holding in the context of a labor dispute that "it is sensible to view the debtor-in-possession as the same 'entity' which existed before the filing of the bankruptcy petition."[14] Simply put, when an entity files for a chapter 11 reorganization, the Bankruptcy Code does not replace the entity that "formerly employed" the employees, to the contrary, the pre-petition employer and post-petition employer are the same entity. As such, even if courts find that a chapter 7 trustee is somehow a new and distinct "employer" entitled to the liquidating fiduciary exception, the same does not ring true for chapter 11 DIPs.

IV Conclusion

In conclusion, the Third Circuit got it wrong when it recognized the liquidating fiduciary exception to employer liability under the WARN Act, and other courts should not adopt the exception. Further, even if courts are inclined to adopt the WARN Act in the context of a chapter 7 case, it should not be applied to DIPs because DIPs are not statutorily distinct employers distinguishable from the pre-petition employers.

[13] *Biltmore Associates, LLC v. Twin City Fire Insurance Co.*, 572 F.3d 663, 671 (9th Cir. 2009).
[14] *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528, 104 S.Ct. 1188, 79 L.Ed. 2d 482 (1984) (statutorily overruled on other grounds by 11 U.S.C. § 1113).