Single-Employer Test Emphasizes De Facto Control Factor

By Barry M. Klayman and Mark E. Felger

Delaware Business Court Insider
July 10, 2013


Barry Klayman


Mark E. Felger

The Worker Adjustment and Retraining Notification Act (WARN Act) provides that an employer may 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 to each affected employee. The purpose of the act is to protect workers and their families by providing them with advance notice of a layoff. Because employee layoffs are a necessary condition to WARN Act liability, and layoffs frequently presage a corporation's demise, plaintiffs frequently attempt to recover from affiliates like a parent company or lender. Two recent decisions from the Delaware bankruptcy and district courts illustrate how the courts deal with such suits. In one, the bankruptcy court granted summary judgment in favor of the parent entity and denied liability; in the other, the district court held that the plaintiffs' complaint stated a claim upon which relief could be granted and survived the parent's motion to dismiss.

In order to recover against an affiliate under the WARN Act, the former employees must show that the affiliate acted with the employer entity as a "single employer" in making the wrongful termination decision. The U.S. Court of Appeals for the Third Circuit has adopted a five-factor balancing test based on Department of Labor regulations to determine whether subsidiary and parent entities should be treated as a single employer. These factors are: (1) whether the companies share common ownership; (2) whether the companies share common directors or officers; (3) the existence of de facto exercise of control by the parent over the subsidiary; (4) the existence of a unity of personnel policies emanating from a common source; and (5) the dependency of operations. These factors are not rigidly applied and are not exhaustive. The Third Circuit emphasizes a "functional approach" that takes into consideration the nature and degree of control possessed by one company over another. Moreover, common ownership and common directors or officers alone are not sufficient to establish that two entities constitute a single employer, and the dependency of operations between two entities cannot be established simply from the parent's exercise of ordinary powers of ownership over the subsidiary.

In *In re Jevic Holding (Czyzewski v. Jevic Transportation)*, Adv. No. 05-50662 (Del. Bankr. May 10, 2013), Sun Transportation, a wholly owned subsidiary of the defendant Sun Capital Partners (Sun Cap), acquired the debtor Jevic Transportation in a leveraged buyout. Upon the merger, Jevic and Sun Cap entered into a management services agreement whereby Sun Cap would provide consulting services to Jevic for a fee. In the following two years, the debtors' business deteriorated and the debtors defaulted on financing covenants with their third-party lender. With the third-party lender refusing to provide more financing and Sun Cap refusing to invest more money, Jevic had two options: Sell the company or file for bankruptcy. When it became apparent that Sun Cap would need to spend more money to close the sale than the sale would generate, Jevic had no alternative but to file for bankruptcy. Jevic sent termination notices pursuant to the WARN Act, but filed for bankruptcy the next day so that the employees effectively failed to receive the requisite 60-day notice. The plaintiffs sued the debtors and Sun Cap for violations of the WARN Act. The parties filed cross-motions for summary judgment on the issue of whether Sun Cap could be held liable as a single employer with the debtors.

The district court discussed each of the five factors in applying the single-employer test. The court found the existence of common ownership between Sun Cap and the debtors, as Sun Cap was the ultimate parent of the holding company that owned the debtors. The court also found that Sun Cap and the debtors shared common directors or officers.

The main thrust of the court's decision is its discussion of the third factor, de facto control by Sun Cap of the debtors. The plaintiffs argued that Sun Cap's decision not to fund the debtors, a general lack of independence, and sharing of in-house counsel weighed in favor of finding de facto control by Sun Cap. However, the court explained that this factor concerns whether the parent has specifically directed the allegedly illegal employment practice that forms the basis for the litigation. It is not intended to find liability based on a parent's exercise of control pursuant to the ordinary incidents of stock ownership. Although the court conceded that the debtors were subject to some oversight by Sun Cap, it found the level of oversight fell short of what was required to establish a single employer. No Sun Cap personnel were involved in the day-to-day operations of the debtors, and Sun Cap was not involved in the decision to terminate employees or shut down facilities. The court was not persuaded that Sun Cap's decision to stop funding the debtors was actionable because it assumed responsibility for the continuing viability of the company. Rather, the court found that the debtors retained the ultimate responsibility for keeping the company afloat and Sun Cap did not incur WARN Act liability by refusing to make an additional investment. The court noted that the debtors sought capital and potential buyers on their own and made the decision to shut down the company themselves. These steps reflect the debtors' own decision-making and demonstrate that Sun Cap's decision to cut off funding was not a de facto exercise of control over the debtors' decision to close its doors. The court also took into account the Third Circuit's concern that it not create a jurisprudence that discourages loans in general or rescues of troubled business enterprises in particular.

The court easily found the remaining two factors to weigh in favor of Sun Cap. The test for unity of personnel policies is whether the companies actually functioned as a single entity with regard to the relationships with employees. The court considered whether the two companies engaged in centralized hiring and firing, payment of wages, and personnel and benefits recordkeeping. The court found insufficient evidence to show a unity of personnel policies between the debtors and Sun Cap. The sharing of certain benefit plans and some employee monitoring functions were not enough to find that the two companies functioned as a single entity. Finally, the court found no dependency of operations. For there to be dependency of operations, the court generally considers the presence of arrangements such as the sharing of administrative or purchasing services, interchanges of employees or equipment, and commingled finances. The mere fact that the top officers of the subsidiary report to the parent does not establish the kind of day-to-day control necessary for an interrelation of operations. Nor are the existence of loans from the parent to the subsidiary sufficient to show a dependency of operations, since the court does not want to discourage companies from attempting to keep their subsidiary operations afloat with temporary loans. The court concluded that Sun Cap and the debtors operated two distinct and separate businesses that were not dependent on each other. Jevic maintained separate books and records, had its own bank accounts, and prepared its own financial statements. It did not share administrative services, facilities or equipment with Sun Cap, and Sun Cap was explicitly an independent contractor under the management services agreement and was compensated for its work. Additionally, Sun Cap employees were not involved in the day-to-day business operations of the debtors. Accordingly, there was no dependency of operations.

In sum, the existence of common ownership and common directors or officers were outweighed by the absence of de facto control, unity of personnel policies or dependency of operations. For these reasons, the court found that Sun Cap was not a single employer with the debtors for purposes of the WARN Act.

The outcome was different in *Woolery v. Matlin Patterson Global Advisers LLC*, C.A. No. 12-726-RGA (D. Del. April 23, 2013), albeit in the context of a motion to dismiss and not a motion for summary judgment. In *Woolery*, the putative class plaintiffs alleged that the defendants made the specific decision to conduct the layoffs in violation of the WARN Act. Although acknowledging the five-factor test, the district court agreed with the plaintiffs that the de facto exercise of control factor is a "special factor." This factor best encapsulates the Third Circuit's view that courts should take a more functional approach by focusing on the nature and degree of control possessed by one corporation over another when undertaking the single-employer analysis.

The court found that the plaintiffs made a strong showing of de facto control. They alleged that defendants took control of the day-to-day decisions of the company and dealt directly with its employees. More importantly, the plaintiffs alleged that the defendants made the specific business decision to conduct the layoffs without 60 days' notice.

After considering the other factors in the Third Circuit's five-factor test, the court found the plaintiffs failed to sufficiently allege common officers or directors, a unity of personnel policies emanating from a common source, or a dependency of operations. Plaintiffs did allege common ownership along with a strong showing of de facto control. The court found this last factor to be determinative in the Rule

12(b)(6) context: "These allegations [of control] exceed a parent's standard exercise of control pursuant to the ordinary incidents of stock ownership. They allege that defendants leveraged their ownership interests to force violations of the WARN Act with knowledge of the illegality of their acts. For this reason, the motion to dismiss is denied as to the WARN Act claim."

The different outcomes in the two cases may be a result of the procedural posture of each case or their specific facts. The opinions are consistent in emphasizing the importance of de facto control in determining whether there is a single employer for purposes of WARN Act liability. Although both cases pay heed to the five-factor balancing test espoused by the Third Circuit, there is little doubt that one factor — the existence of de facto control — counts much more than the rest. And de facto control seems to reduce itself to whether the parent or lender participated in the specific decision to order a plant closing or mass layoff without the requisite 60-day advance notice. The presence of such control is crucial to a finding of single-employer liability under the WARN Act.

Barry M. Klayman *is a member in the commercial litigation group and the bankruptcy, insolvency and restructuring practice group at Cozen O'Connor. He regularly appears in Chancery Court.*

Mark E. Felger *is co-chair of the bankruptcy, insolvency and restructuring practice group at the firm.*