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The Emerging Impact of the WARN Act in Bankruptcy Cases

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The addition of Section 503(b)(1)(A)(ii) to the Bankruptcy Code pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) may create a trap for debtors and their professionals who are unaware of recent decisions finding that administrative priority claim status may be available under Section 503(b)(1)(A)(ii) for claims arising from a debtor’s alleged post-petition failure to comply with the Worker Adjustment and Retraining Notification Act (“WARN Act”).¹

Section 503(b)(1)(A)(ii) designates administrative status to claims for “wages and benefits” that are awarded pursuant to a judicial proceeding or proceeding of the National Labor Relations Board as a result of a “violation of Federal or State law by the debtor.” A recent bankruptcy court decision, In re Powermate Holding Corp., 394 B.R. 765, 775 (Bankr. D. Del. 2008), considered whether certain employees’ WARN Act claims, which arose from their-petition termination by the debtor, were entitled to administrative status under Section 503(b)(1)(A)(ii).

The WARN Act was passed in 1998 in the aftermath of numerous plant closings and mass layoffs arising from corporate mergers. It requires employers – a term specifically defined by the Act – to provide 60 days’ written notice to employees of a plant closing or mass layoff in certain enumerated circumstances. In the absence of such notice, an employee is entitled to “back pay,” that is, pay he or she otherwise would have earned had sufficient notice of termination been provided. The purpose of the WARN Act was to provide a statutory form of severance pay and the fastest possible readjustment and retraining of displaced workers.²

Before the addition of Section 503(b)(1)(A)(ii), bankruptcy courts traditionally treated pre-petition WARN Act claims as “wages” and afforded such claims priority status pursuant to Section 507(a) of the Bankruptcy Code.¹ This is significant because Section 507(a) claims are given a lower status than claims found to have administrative expense priority under Section 503. Specifically, Section 507(a) claims are given fourth- or fifth-priority status under the Bankruptcy Code, and the current maximum dollar amount allowed for each individual asserting such a claim is \$10,950. Additionally, a Section 507(a)(4) or 507(a)(5) claim must have been “earned” within 180 days before the date of filing. Amounts in excess of the cap are treated as general unsecured claims.

In Powermate, former employees of the debtor filed a complaint alleging violations of the WARN Act and seeking wages and other benefits. The employees also asserted that the claims arising from damages awarded pursuant to the lawsuit should be given administrative priority status pursuant to Section 503(b)(1)(A)(ii). The debtor filed both an answer and a motion to dismiss the complaint. As part of its motion to dismiss, the debtor sought a judicial determination that any damages awarded to the plaintiffs pursuant to their WARN Act claims should not be treated as administrative expense claims pursuant to Section 503(b)(1)(A)(ii), but as claims governed by Section 507(a).

Noting the manner in which pre-petition WARN Act claims were historically treated before BAPCPA, the Powermate court stated that “a claim for severance pay under the WARN Act will be granted administrative priority only to the extent that the claim is based on post-petition services.” Because the debtor had terminated the WARN Act plaintiffs’ employment pre-petition, the court held that their claim was not entitled to administrative status under Section 503(b)(1)(A)(ii). Finding that a WARN Act entitlement to severance pay constitutes “pay at termination in lieu of notice,” the Powermate court stated

that a WARN Act claim vests in its entirety at the time of termination. Thus, under Powermate, a post-petition termination claim should receive administrative expense claim treatment “in its entirety.” Powermate teaches that an unwary debtor faces the potential for claims with vastly different treatment under the Bankruptcy Code, depending on whether a mass layoff or plant closing takes place pre- or post-petition. Given that Section 503(b)(1)(A)(ii) is not subject to the statutory cap set forth in Section 507, debtors and their professionals should consider Powermate during any pre-bankruptcy planning.

The vast majority of courts have yet to rule on the issue of whether the recently added Section 503(b)(1)(A)(ii) applies to WARN Act claims.¹ Although courts outside the District of Delaware are not bound by Powermate, it is likely they will review that cogently reasoned opinion when deciding the issue of whether administrative priority status should be accorded for WARN Act claims to employees terminated post-petition.

Debtors and their professionals also should familiarize themselves with state statutes governing mass layoffs, severance and employee notification periods, which may include more stringent requirements than the WARN Act. For example, on February 1, 2009, a new section of New York state labor law became effective.¹ The New York statute applies to employers with at least 50 employees (as opposed to 100 under the WARN Act) and requires that employers provide at least 90 days’ notice (as opposed to 60 days under the WARN Act) to employees. New York also enacted arguably broader definitions of “mass layoff” and “plant closure.” Other states that have enacted labor laws addressing terminations, mass layoffs, and/or notice periods to terminated employees include, but are not limited to, California, Illinois, Maryland, Michigan, New Jersey and Wisconsin.

¹ 29 U.S.C. § 2101 et seq.

² See *In re First Magnus Financial Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008).

³ See, e.g., *In re First Magnus Financial Corp.*, 390 B.R. at 672.

⁴ The *First Magnus* case, *supra*, was the first case to consider the issue of whether 503(b)(1)(A)(ii) applied to WARN Act claims. A recent Third Circuit decision, *In re APA Transport Corp. Consolidated Litigation*, 2008 WL 3982469 (3d Cir. 2008), considered whether a debtor could avoid liability under the WARN Act pursuant to an exception called the “faltering company” exception.

⁵ See New York Labor Law §860 et seq.