Delaware District Court Permits WARN Class Action to Proceed Against Equity Sponsor as *De Facto* Employer

The United States District Court for the District of Delaware,[1] recently declined to dismiss a putative class action filed by former employees under the Workers Adjustment and Retraining Notification Act (the "WARN Act") against certain private equity fund entities that were the former majority owners of Premium Protein Products, LLC ("Premium").[2]

The private equity defendants purchased a majority interest in Premium's parent company, PPP Holdings, LLC ("PPP"), with PPP's board of directors entirely controlled by the defendants, and designees of the defendants occupying management positions at both Premium and PPP. In addition, the defendants allegedly took control of day-to-day decisions of Premium, dealt directly with Premium's employees, and made key management decisions, including the employment decisions that gave rise to the litigation. When Premium's business began to decline in 2008, employees were notified that Premium would be forced to shut down if the company did not turn a profit by April 2009, and in June 2009, Premium's facilities were closed, and employees were informed that the closures were temporary furloughs. In November 2009, after consultation with and input from the defendants, who allegedly believed that a bankruptcy filing made notice under the WARN Act unnecessary, the employees were officially terminated, without WARN Act notices being sent, and Premium commenced a bankruptcy proceeding.[3]

The court held that an equity sponsor, in addition to the nominal employer, can be liable under the WARN Act for failing to provide employees with at least 60 days' notice of termination or payment in lieu of notice, if former employees show that the sponsor *acted together with the portfolio company as a "single employer"* in making the offending employment decisions.[4] The Court applied the following five-factor balancing test set forth in Department of Labor Regulations, drawn from corporate veil piercing theories:

(i) whether the companies share common ownership,

(ii) whether the companies share common directors and/or officers,

(iii) the existence of *de facto* exercise of control by the sponsor over the portfolio company,

(iv) the existence of a unity of personnel policies emanating from a common source, and

(v) the dependency of operations between the companies.[5]

In denying the defendants' motion to dismiss, the court considered each of these factors, finding that the plaintiffs sufficiently alleged common ownership and *de facto* exercise of control, but that they did not sufficiently allege the other factors. However, the court emphasized that, in the Third Circuit, "Courts 'take a

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1 *Woolery v. Matlin Patterson Global Advisers, LLC*, No. C.A. 12-726-RGA, 2013 WL 1750429 (D. Del. Apr. 23, 2013) available at http://www.ded.uscourts.gov/sites/default/files/opinions/rga/2013/april/12-726.pdf.

2 Many of the facts described herein have not yet been proven by the plaintiffs, but the court assumed them to be true in the context of the motion to dismiss.

3 *Id*. at *1-2.

4 *Id*. at *2-3 (emphasis added).

5 *Id*.; 20 C.F.R. § 639.3(a)(2).

more functional approach to determining whether or not to 'pierce the veil' under the WARN Act by focusing on the nature and degree of control possessed by one corporation over another.'"[6] The court also noted that the "de facto exercise of control factor is a special factor" and "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'", despite the defendants' argument that "adopting such perspective may jeopardize basic principles of limited liability ownership".[7] Specifically, in denying the defendants' motion to dismiss, the court reasoned that the plaintiffs' allegations made a particularly strong showing on the "de facto exercise of control factor", observing that the defendants are alleged to have "leveraged their ownership interest to force violations of the WARN Act with knowledge of the illegality of their actions."[8] Based on this factor and a showing of common ownership, the Court allowed the WARN Act claim to proceed.

The *Woolery* decision should be of great interest to private equity firms, which must be cognizant that liability under the WARN Act may extend beyond portfolio company nominal employers, even if the corporate structure would otherwise appear to shield such liability. Distressed portfolio companies may be subject to the notice requirements under the WARN Act and similar obligations under state and local law, even where such compliance is costly, burdensome, or causes delay, and failure to comply could give rise to claims against parties other than the employer. To manage their potential WARN Act exposure, private equity firms should respect corporate formalities and endeavor to minimize their direct involvement in the operations of their portfolio companies, especially in connection with decisions regarding employee layoffs and plant closures that could give rise to WARN Act liability on the nominal employer.[9]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Joel H. Levitin at 212.701.3770 or jlevitin@cahill.com; Richard A. Stieglitz Jr. at 212.701.3393 or rstieglitz@cahill.com; Glenn J. Waldrip, Jr. at 212.701.3110 or gwaldrip@cahill.com; Mark J. Gelman at 212.701.3061 or mgelman@cahill.com; or Maya Peleg at 212.701.3969 or mpeleg@cahill.com.

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[6] *Id*. at *3.

[7] *Id*. at *3.

[8] *Id*. at *6.

[9] Equity sponsors should be aware that overstepping boundaries can also lead to exposure on other liability theories.

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