Duty To WARN

>>> Laid-off Employees and the Impact of the Bankruptcy Code

A company that is contemplating filing for protection under Chapter 11 of the Bankruptcy Code is often facing both operational and financial challenges. While an integral part of most corporate restructuring strategies involves cutting staff, companies must be mindful of limiting their liability when laying off employees.

A company that is planning workforce reductions must consider the implications of the Workers Adjustment and Retraining Notification Act (WARN Act), which provides that affected employees are entitled to at least 60 days' notice of a potential termination. When an employer fails to give such a warning, the affected employees are entitled to back pay and benefits for up to 60 days. However, that may not be the case for a company in bankruptcy.

According to court decisions in the *In re Powermate Holding Corp.*, and *In re First Magnus Financial Corporation* bankruptcies, laid-off workers may be denied statutory pay benefits. In these cases, the employers successfully argued that upon entering bankruptcy, employees become general unsecured creditors – entitled to little if any recovery – with respect to their claims for pay benefits resulting from their employer's failure to provide advance notice as required under the WARN Act.

In *Powermate* and *First Magnus*, former employees argued that the portion of the 60-day WARN Act liability period that occurred after the bankruptcy filing date was an administrative claim – entitled to a higher priority – while the debtor/employer asserted that the claims were general unsecured claims.

This distinction between administrative and general unsecured claims is critically important because administrative claims must be paid in cash in full in order for a plan of reorganization to be confirmed, while unsecured creditors are often paid only a small fraction of the face amount of their claims.

Although the courts' rationales differed, both held that the former employees' claims were mere general unsecured claims. The courts emphasized that if the former employees' interpretation was accepted, a debtor's ability to reorganize would be severely hampered, if not crippled, due to the full payment requirement.

Even though decided within the specific context of the WARN Act, these cases provide a good example of the tension between creditors attempting to elevate the status of their claims and debtors arguing for unsecured treatment with the future of their business on the line. If you'd like to learn more about the WARN Act and/or bankruptcy issues in general, please contact our office.

Bankruptcy
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