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EMPLOYEE BENEFITS IN BANKRUPTCY

The WARN Act Makes a Comeback, with Class
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I. Introduction: The Comeback

Employee benefits in bankruptcy have long been granted special treatment to a limited extent, as priority unsecured claims under Bankruptcy Code § 507. These include wages, compensation, commissions, vacation, severance, and sick leave pay for individuals, in the amount of \$10,950 earned within 180 days of the filing, after April 1, 2007. Priority unsecured claims are paid before general unsecured claims. There has been no administrative claim for these amounts unless they arose for services rendered post-petition, after the case was filed.

Under BAPCPA, however, which became effective on October 17, 2005, a provision was inserted into Code § 503(b)(1)(A) which added a subpart (ii). This addition grants administrative priority to wages and benefits that are awarded . . . as back pay attributable to any period of time occurring after the bankruptcy case was filed, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrences of unlawful conduct on which such award is based, or to whether any services were rendered.

This new provision added by BAPCPA has been interpreted by WARN Act advocates to open the door for a comeback by the WARN Act, with class. The added language addressing back

pay “attributable” to any post-petition period, regardless of when the bad act occurred or whether any services were actually rendered, seems to play right into the scope of WARN Act claims to give them administrative expense priority in bankruptcy.

The difficulty and issues arise, however, from the same source as with other problems with some other BAPCPA provisions: the language used is not light and the legislative history is not helpful, so the one Bankruptcy Judge that addressed these issues has done his best to reach results that he saw as consistent with the Bankruptcy Code, but not favorable to the comeback.

II. What Is the Warn Act?

Specifically, the WARN Act is the Federal “Worker Adjustment and Retraining Notification” Act, at 29 U.S.C. § 2101, et seq. The WARN Act was passed in 1988, based on the large number of plant closings and mergers in volatile but depressed economic times, similar to what we have today. The Act requires that employers subject to the Act give their employees 60 days’ written notice of a plant closing or a mass layoff. 29 U.S.C. § 2102(a). The purpose of the WARN Act is to ensure that workers receive advance notice of plant closures and mass layoffs that affect their jobs. Marques v. Telles ranch, Inc., 131 F.3d 1331, 1333-1334 (9th Cir. 1997). The Act was intended to allow “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.” 20 C.F.R. § 639.1(a).

The WARN Act is primarily remedial, *i.e.*, it is intended to ensure an income stream or protection to works, their families and communities by providing the most rapid possible readjustment and retraining of displaced workers and to ease the personal and financial difficulties of the terminated workers. Local Joint Exec. Bd. Of Culinary/Bartender Trust Fund v. Las Vegas Sands, Inc., 244 F.3d 1152, 1159 (9th Cir. 2001); and In re Hanlin Group, Inc., 176 B.R. 329, 333-34 (B.C. D.N.J. 1995) (the purpose of WARN is to provide a statutory form of severance pay).

Courts have regularly held that the WARN Act is “particularly amenable to class litigation.”

Finnan v. L.F. Rothschild & Co., 726 F. Supp. 460, 465 (S.D.N.Y. 1989); See also Grimmer v. Lord, Day & Lord, 1996 WL 139649, *8 (S.D.N.Y.) (“[T]he WARN Act provisions lend themselves to class action because they provide for limited recovery.”); New Orleans Clerks and Checkers Union Local 1497 v. Ryan-Walsh, Inc., 1994 U.S. Dist. LEXIS 2403 (E.D. La. 1994) (“the instant proceeding, a WARN action, falls squarely within the criteria for sanctioning a class”). Because of this, violations of the WARN Act have spawned a number of class action cases, in which class certification is usually granted.

III. Are Class Actions Available In Bankruptcy Cases?

There is authority that class actions are available in bankruptcy cases. One Judge has observed that Rule 23 (the class action Rule) of the Federal Rules of Civil Procedure “does not automatically apply to contested matters, see Fed. R. Bankr. P. 9014.” In re First Magnus Fin. Corp., No. 4:07-bk-01578-JMM (B.C. Ariz. 2008), at 2008 WL 2491636.

However, Rule 7023, Federal Rules of Bankruptcy Procedure, makes Rule 23 of the Federal Rules of Civil Procedure fully applicable, without any changes, to adversary proceedings in bankruptcy courts. Because a class action cannot be presented in bankruptcy as a contested matter, and must be filed as an adversary proceeding, as it was in the First Magnus case above, class actions in bankruptcy cases are fully available under Rules 23 and 7023.

IV. Why A Class Action?

As referenced and cited above, WARN Act claims are particularly amenable to litigation by class actions. The procedure of class actions just fits particularly well with the nature, the legal bases, the issues, and the limited recoveries involved on WARN Act claims. Aside from this, however, there is a practical consideration for the pursuit of a class action for WARN Act claimants in a bankruptcy case.

The Bankruptcy Code has long recognized that certain types of creditors in bankruptcy are vulnerable, because they typically have a large number of small claims that individually are not

worth litigating about, and they are generally unsophisticated creditors. These creditors, who are probably injured proportionately more by the bankruptcy filing than other types of creditors, and are definitely vulnerable to being run over by the process, definitely require some protection. They face claims filing bar dates, the plan of reorganization or liquidation, additional imposed deadlines, claims objections by the debtor or a liquidating trustee or claims administrator, (for late claims, insufficiently undocumented claims, and other grounds), and related proceedings. Some get through the process alright, but many others give up, lose touch, fall out, or are otherwise excluded from any recovery at all.

The Bankruptcy Code provides a mechanism for these kinds of creditors to form and be represented as a group, under Code § 1102, entitled “Creditors’ and equity security holders’ committees”. This will be covered specifically later in these materials. The point is: the Bankruptcy Code acknowledges that these types of creditors are vulnerable and need a group voice, through a Court-appointed committee.

V. What Is Required For A Class Action?

The requirements for a class action, and specifically for certification of a class of claimants, are set forth in Rule 23, Federal Rules of Civil Procedure. The Rule has 4 prerequisites in Rule 23(a) (1)-(4), and also requires that the proposed class meet one of the three subparts in Rule 23(b). These are as follows:

Rule 23. Class Actions

(a) Prerequisites. One or more members of a class may sue or be sued as representative parties on behalf of all members only if:

- (1) the class is so numerous that joinder of all members is impracticable;
- (2) there are questions of law or fact common to the class;
- (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and
- (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Types of Class Actions. A class action may be maintained if

Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create, a risk of:

(A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or

(B) adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests;

(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole; or

(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. The matters pertinent to these findings include:

(A) the class members' interests in individually controlling the prosecution or defense of separate actions;

(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;

(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and

(D) the likely difficulties in managing a class action.

The first prerequisite, Rule 23(a)(1), is straight forward: joinder need not be impossible, just “impracticable.” Grimmer v. Lord Day, 937 F.Supp. 255 (S.D.N.Y. 1996) (certifying a class of 92 claimants). The second prerequisite is similarly straight forward. Under Rule 23(a)(2), class relief is ‘peculiarly appropriate’ when the ‘issues involved are common to the class as a whole’ and they ‘turn on questions of law applicable in the same manner to each member of the class.’ For in such cases, ‘the class-action device saves the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23.’” General Tel. Co. V. Falcon, 457 U.S. 147, 155 (1982), quoting, Califano v. Yamasaki, 442 U.S. 682, 700-701 (1979).

The third prerequisite, Rule 23(a)(3), is met if the elements for the representatives’ cause of action are the same as those of the class in general, because then the claims are “typical”. Dura-Bilt Corp. V. Chase Manhattan Corp., 89 F.R.D. 87, at 99 (S.D.N.Y. 1981).

The fourth prerequisite requires that the representatives of the class have interests that are free from conflicts of interest with the class they are proposed to represent, and that the class will be represented by qualified counsel. Amchem Products v. Windsor, 521 U.S. 591, at 625 (1997); and Rodger v. Electronic Data Systems corp., 160 F.R.D. 532 (E.D.N.C. 1995).

Finally, the last requirement is to satisfy one of the three alternative requirements in Rule 23(b). This will depend on the facts of the case. The facts will also dictate the definition of the class that is approved by the Court, as well as the notice to be given. A question may arise as to whether a class can represent the claims of all its class members where not all of them filed individual proofs of claims, and the answer is yes, and a class proof of claim can be filed. See In re Zenith Laboratories, 104 B.R. 659, at 644 (D.N.J. 1989); In re Kaiser Group Intern., Inc., 278 B.R. 58, at 63-64 (B.C.D. Del. 2002); In re First Alliance Mortgage Corp., 269 B.R. 428, at 444 (D.C. Cal. 2001); and In re Birting Fisheries, Inc., 92 F.3d 939, at 940 (9th Cir. 1996).

These cases also demonstrate that class actions are authorized and available in bankruptcy cases.

**VI. The Bankruptcy Courts' Treatment Of Class Actions And
WARN Act Claims Before BAPCPA**

As seen from the many cases cited above, Bankruptcy Courts have generally recognized class actions in bankruptcy cases, under Rule 7023, Federal Rules of Bankruptcy Procedure.

Bankruptcy Courts have also treated pre-petition WARN Act back-pay claims, in cases prior to BAPCPA (eff. October 17, 2005), as wages rather than as penalties, affording such claims a priority treatment under § 507(a), up to the maximum amount allowed by the statute. Any amount of a WARN Act claim over that amount was treated as an unsecured claim. In re Kitty Hawk, Inc., 255 B.R. 428, at 439 (B.C.N.D. Tex. 2000).

In Kitty Hawk, the Court considered administrative treatment for the WARN Act claims, and concluded that those claims under the WARN Act in that case arose pre-petition, when the employees were terminated in mass, and they were not entitled to administrative expense priority. 255 B.R. at pages 437-438. See also In re Cargo, Inc. 138 B.R. 923, at 927-928 (B.C.N.D. Iowa 1992); In re Health Maintenance Foundation, 680 F. 2d 619 (9th Cir. 1982); and in re Palau Corp., 18 F.3d 746 (9th Cir. 1994). Of course, these cases are prior to BAPCPA as well.

The last case cited, Palau Corp., is significant here because that case involved a prior award by the National Labor Relations Board (NLRB), and an attempt by the NLRB in Palau Corp. to obtain administrative expense priority for the back-pay claims of employees, that accrued to employees wrongfully discharged by the employer-debtor before the Chapter 11 debtor filed its bankruptcy case. The Court in Palau Corp. looked to Code § 503(b)(1)(A), now § 503(b)(1)(A)(I), and held that these WARN Act claims were not entitled to be treated as administrative expense claims. That's what the Code said at that time.

VII. The Amendment Of The Code

In October 2005, BAPCPA became effective, and with it the scope of § 503(b)(1)(A) was broadened, by adding § 503(b)(1)(A)(ii), as follows:

(b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title, including –

(1)

(A) the actual, necessary costs and expenses of preserving the estate, including –

(I) wages, salaries, and commissions for services rendered after the commencement of the case; and

(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceedings of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title;

It appears that Congress intended to change the law of § 503(b)(1)(A) so that any new case presenting the issue of Palau Corp., above, would reach the opposite decision. The NLRB proceeding that awarded back-pay to the employee-creditors of the Chapter 11 debtor would now be awarded administrative expense priority in a new case like Palau Corp.

There is more to the new statute, however, than back-pay awards from the NLRB prior to the bankruptcy filing. The added language, § 503(b)(1)(A)(ii), adds “wages and benefits awarded pursuant to a judicial proceeding” . . . as back pay . . . can also obtain administrative expense treatment. The question is: When will this basis for administrative expense priority to back-pay claims arise?

First, because a mass lay-off of employees will most often result in the employer closing, and/or filing a bankruptcy, the employees’ opportunity to complete a “judicial proceeding”, before the bankruptcy is filed, is fairly limited. If the claims are substantial enough, the employer may even file bankruptcy before the “judicial proceeding” is completed, thereby avoiding the result of the completed proceeding, and the effect of Code § 503(b)(1)(A)(ii).

Second, and alternatively, the Bankruptcy Court itself could conduct that “judicial proceeding” to render the back-pay award, and then consider administrative expense priority for the award under the new provision of the statute. There is nothing in the wording of the statute or the Bankruptcy Code to preclude the Bankruptcy Court from hearing and deciding such a “judicial proceeding”, and allowance of claims is a core proceeding in bankruptcy cases. Claims litigation is at the heart of bankruptcy proceedings.

VIII. The Recent Bankruptcy Court Decision On A Class Action For WARN Act Claimants

Recently, the Bankruptcy Court for the District of Arizona, Southern Division, addressed the combined issues of (1) class certification for the WARN Act claimants of Debtor and (2) allowance of WARN Act claims with administrative expense priority under Code § 503(b)(1)(A)(ii). In re First Magnus Fin. Corp., Adversary No. 4:07-ap-0060-JMM, Case No. 4:07-bk-01578-JMM, 2008 WL 2491636 (The second decision was rendered under the case number).

That court issued two decisions on these issues. On January 10, 2008, the court issued its Order denying class certification, holding that recognizing such a class would unnecessarily increase the costs and reduce the distribution to the proposed class members. The Court went on to state that each member of the class will have to file a claim, and each one would be addressed on its merits,

as each member of the class received pertinent notices and is or should be aware of the deadlines and time tables for action. This decision was rendered in the adversary, Adv. No. 4:07-ap-0060-JMM. The stated basis for the denial is not contained anywhere in Rule 23, Federal Rules of Civil Procedure, as a reason to deny the class.

The facts of the case show that the bankruptcy was filed on August 21, 2007, and the claims bar date was set by the Court for December 3, 2007, not quite 3 ½ months later. Debtor's Disclosure Statement was approved, and the ruling on the class certification was decided, in January 2008.

On June 20, 2008, the Court issued its order interpreting Code § 503(b)(1)(A)(ii) and denying any administrative expense priority to the WARN Act claims of debtor's former employees. The law of In re Kitty Hawk, Inc., 255 B.R. 428 (B.C.N.D. Tex. 2000) was found to apply, and Code § 503(b)(1)(A)(ii) was found to have no application.

This second decision of the Court is the subject of an article in the recent issue of the ABI Journal, September 2008, Vol XXVII, No. 7, beginning on page 1. The conclusion in the article is that the Court "was correct across the board."

In reaching this second result, the Court in First Magnus considered several aspects of the issue presented, and ultimately reached two conclusions. First, the use of the joining word "and" between Code § 503(b)(1)(A)(I) and (ii) meant both provisions had to be satisfied, even though subpart (ii) covers any claim "attributed" to any period after the filing, and regardless of whether any services were rendered. Second, the Court concluded that it had no power or authority to conduct the "judicial proceeding" referred to in Code § 503(b)(1)(A)(ii), disagreeing with the view stated in In re Preston Trucking Co., Inc., 333 B.R. 315 (B.C.N.D. 2005), that bankruptcy courts have jurisdiction over claims for wages and other employee grievances in a bankruptcy case.

While this second decision may have legal support, it is disappointing. It is disappointing because the language of the statute arguably does not provide what Congress apparently, or arguably, intended the new provision to accomplish, and because this decision makes Code § 503(b)(1)(A)(ii) an extremely minor provision of BAPCPA that will rarely have any application for,

or be helpful to, devastated former employees who suffer extensive losses beyond loss of their jobs and paychecks.

The court itself in First Magnus acknowledged that some bankruptcy scholars had opined on this subject, and their considered opinions seem to believe that the statute is clear. The Court's footnote to this statement (footnote 4) is as follows:¹

This writer has seen the extensive multiple omnibus objections, filed by the First Magnus Liquidating Trustee against claims by the former employees of the Debtor on different grounds (timeliness, documentation, etc.), and has observed that this case has been extremely bad for those former employees. It seems that there should surely be a better way to handle them.

IX. An Alternative to Class Action

The first decision of the Bankruptcy Court in the First Magnus case, above, denied class certification to the proposed WARN Act class, on the basis of increased burden on the case. On the other hand, the Court had no issue with the appointment of a committee for unsecured creditors, and its Texas counsel, or the payment of the legal fees of the committee. Indeed, it appears that all legal fees sought in the case were granted.

¹ (4) The WARN employees have some legal support for their “plain meaning” interpretation. Collier cites no case law or legislative history, but yet opines that “if a judicial or NLRB award of back pay spans a period covering conduct occurring both pre-petition and post-petition based on employer conduct commencing during the pre-petition period, the post-petition portion would qualify as an administrative expense.” 4 Collier on Bankruptcy, supra, ¶ 503.6[7][e], at 503-47. The same interpretation is also acknowledged by other scholars. See R.J. Keach, CAPCPA and WARN Act ‘Back Pay:’ Now, Timing Isn’t Everything,” 24-Jan. Am. Bankr. Inst. J. 26 (2006) (“‘Plain meaning’ advocates will have little trouble applying this section to create administrative claim status for WARN Act back-pay awards arising out of pre-petition layoffs or facilities closings where the notice period runs, and the liability for and amount of the back-pay award is adjudicated post-petition.”); see also Honorable Wm. Houston Brown, 2005 Bankr. Reform Legis. With Analysis 2d § 9.71 (2006) (stating that under BAPCPA “administrative expense have been expanded to include certain post-petition back-pay wards regardless of the time of the underlying conduct,” citing 503(b)(1)(A)(ii). He also states that “[a]s with many of the changes in this area, the increase in these priority claims may reduce recoveries to general unsecured claimants.”).

An alternative to a class action for the WARN Act claimants, then, could be to appoint a committee for them under Bankruptcy Code § 1102(a)(2). Such a committee could then take actions to protect the former employees, which need protection and representation more than unsecured creditors, particularly the large ones. Unsecured creditors lost money; but former employees not only lost money, many had to relocate as all looked for new jobs, many drew down their retirement accounts, and almost all experienced the severe stress of suddenly being terminated and displaced.

Precedent for such a committee can be found in the case of In re Mansfield Ferrous Castings, Inc., 96 B.R. 779 (B.C.N.D. Ohio 1988), where the Bankruptcy Court granted appointment of an additional committee representing employees of the debtor, because the creditors' committee already appointed had objected to this additional committee (just as the unsecured creditor's committee did on the WARN Act claimants' class action relief, in the First Magnus case), and thus demonstrated that it was not in a position to adequately represent the interests of the employees.

This kind of request was not made in the First Magnus case, above, but based on the response of the Court there to the request for class certification, the result would probably have been the same, even though the unsecured creditors committee increased the burden to the case unnecessarily because each unsecured creditor received pertinent notices and was or should have been aware of the case deadlines and time tables for action.

This alternative, of the appointment of a committee, is not as useful for the WARN Act claimants as the class action could have been, but it may be a viable alternative, and it would have been better than nothing.

X. Conclusion

The amendment of § 503(b)(1)(A) of the Bankruptcy Code, to add subpart (ii); and the attempted comeback by the WARN Act in bankruptcy cases, with class; have clearly suffered a setback. Experience reveals that this setback needs to be addressed and corrected, if claims by former employees upon mass lay-offs are to receive greater protection in bankruptcy cases, because experience also reveals that they do need it. Our courts need to treat litigants fairly.