AE Liquidation: WARN Act Comfort for Debtors Attempting a 363 Sale, or Just the 'Putin Exception'?

By Russell C. Silberglied and Katherine M. Devanney

In *In re AE Liquidation*, 2017 WL 3319963 (3d Cir. Aug. 4, 2017) (the Third Circuit Opinion or *AE Liquidation*), the U.S. Court of Appeals for the Third Circuit held that a WARN Act notice only must be given when mass layoffs are probable, not when merely foreseeable. As a result, a debtor that was attempting to effectuate a going concern sale under Bankruptcy Code Section 363 was not liable for failing to give a WARN Act notice until the day it determined it could no longer wait for approvals from the buyer to close. The case can be viewed as providing assurance to debtors that they can attempt a going concern sale without having to provide a potentially damaging "conditional" WARN Act notice.

But the facts of the case are quite unusual. The final approvals from the buyer had to be provided by none other than Russian Prime Minister Vladimir Putin. He stalled, so the approvals were not obtained. Was the court simply reluctant to hold a company accountable for the actions of the Russian dictator, or can the opinion be read more broadly? The authors conclude that, as unusual as it is to encounter Vladimir Putin in a Section 363 sale, *AE Liquidation* need not be read so narrowly.

While this particular transaction was doomed by the stringing along from an atypical, high-profile source in Putin, it is the unexpected failure to close that ultimately mattered, rather than the personage of Putin. As a result, *AE Liquidation* encourages debtors to seek a value maximizing transaction until it becomes probable that it will fail — an optimal result.

Background

Eclipse Aviation Corporation (Eclipse) was an aviation engineering and manufacturing firm with approximately 945 employees. Its largest shareholder was European Technology and Investment Research Center (ETIRC). *AE Liquidation, Inc. v. Eclipse Aviation Corp.*, 522 B.R. 62, 65 (Bankr. D. Del. 2014) (the Bankruptcy Opinion). Roel Pieper (Pieper") served as Chairman of both Eclipse and ETIRC. *Id.*

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Eclipse's board of directors elected to pursue a Chapter 11 going concern sale. *Id*. at 64. ETIRC, which was providing the debtor-in-possession financing, emerged as the stalking-horse bidder. *Id*. at 64. The Debtor received no other qualifying bids for the company. On Jan. 23, 2009, the court entered an order approving the sale to ETIRC. Third Circuit Opinion, at *2.

Under the terms of the Asset Purchase Agreement (the APA), a Russian state-owned bank, Vnesheconombank (VEB), was to provide ETIRC with a $205 million loan to finance the sale. *Id*. The APA did not specifically require ETIRC to retain Eclipse's employees, but it did require Eclipse to "continue its full operations" through closing. *Id*. That could only be accomplished by maintaining substantially all employees.

The sale was originally scheduled to close on Jan. 29, 2009. *Id*. at *3. It did not. VEB instead proceeded to take ETIRC and Eclipse "on a roller coaster ride of promises and assurance that never came to fruition." *Id*. On Jan. 29, 2009, when VEB unexpectedly became insolvent, Pieper informed Eclipse's board that he had been personally assured by Vladimir Putin that Putin himself would make a decision by Feb. 2 as to whether the sale could still be funded. *Id*.

But Putin made no such decision. Instead, on Feb. 3, Pieper reported to Eclipse's board of directors that VEB would be recapitalized on Feb. 5, and there was a "high likelihood" (but no guarantee) that the sale would be approved by the Russian parliament that day. *Id*. Eclipse's disinterested directors demanded specific documentation evidencing the recapitalization of VEB. *Id*. Without such documentation, the directors threatened to recommend calling off the sale and converting the case to a Chapter 7 liquidation. *Id*.

The Russian Parliament approved the recapitalization and the funding of the sale on Feb. 5. *Id*. However, when Pieper arrived in Moscow on Feb. 10 to sign documents finalizing the agreement, he was surprised to learn that the recapitalization had not yet occurred and was not scheduled to occur until Feb. 13, with the funding shortly thereafter. *Id*. Nevertheless, Pieper described the meeting as "positive," and left Russia believing that all that remained was "execution and timing." *Id*.

Meanwhile, Eclipse was rapidly running out of cash. It had become administratively insolvent on Feb. 6, and was on pace to run out of money on Feb. 20. *Id*. Eclipse's disinterested directors resolved that, if ETIRC had not received at least a "satisfactory confirmation" of the funding by Feb. 16, they would recommend a Chapter 7 liquidation or a furlough of all employees while waiting for the VEB financing to arrive. *Id*.

On Feb. 16, 2017, a Russian Governor informed Eclipse's board that VEB had been recapitalized and that quickly funding the Eclipse project was "one of Prime Minister Putin's top priorities." *Id*. After receiving these assurances, the disinterested directors decided against liquidation, but agreed to move forward with the furlough if the funding did not arrive the following day. *Id*. The funding did not arrive, and, on Feb. 18, Eclipse employees were informed that they were being furloughed. *Id*. At this point, the company was set to run out of money by Feb. 27. *Id*.

On Feb. 19, Pieper reported to the board that the money had been allocated, and that the only thing needed was the final signature of Prime Minister Putin. *Id*. at *4. But that signature did not arrive. On the morning of Feb. 21, Pieper informed the board that he expected the funding to be approved later that afternoon.

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Russell C. Silberglied is a director and **Katherine M. Devanney** is an associate at Richards, Layton & Finger in Wilmington, DE. *The views expressed herein are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.*

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Id. However, when the board reconvened later that day, it was told that, despite all the previous indications to the contrary, Prime Minister Putin still needed time to make a decision. *Id*. ETIRC made one more personal plea to Putin on Feb. 23. *Id*. When no commitment came, the noteholders filed a motion to convert the case to Chapter 7.

Once the motion was filed, Eclipse emailed its employees to inform them that the sale had failed and the case was being converted to a liquidation. *Id*. The email explained that the furlough had been converted to a layoff, effective as of Feb. 19. *Id*.

The WARN Act Only Requires Notice When Layoffs Become Probable

The terminated Eclipse employees (the Employees) sued, alleging that Eclipse violated the Worker

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Adjustment and Retraining Notification Act (the WARN Act), 29 U.S.C. §§ 2101-2109, by failing to give the Employees the required 60 days' notice of their pending termination. Bankruptcy Opinion, at 65. Eclipse argued that it was excused pursuant to the "unforeseeable business circumstances" exception. Third Circuit Opinion, at *5. This "exception" is an affirmative defense available to an employer when "the closing or mass layoff is caused by business circumstances that were not reasonably foreseeable as of the time that notice would have been required." 29 U.S.C. § 2102(b)(2)(A).

In granting summary judgment against the Employees, the bankruptcy court applied the "probability" standard of foreseeability used by other circuit courts of appeal: "[i]n determining whether a crippling business circumstance is foreseeable, we must bear in mind that 'it is the probability of occurrence that makes a business circumstance reasonably foreseeable, rather than the mere possibility of such a circumstance.'" Bankruptcy Opinion, at 69 (citing *Roquet v. Arthur Andersen LLP*, 398 F.3d 585, 589 (7th Cir. 2005) (quoting *Watson v. Mich. Indus. Holdings, Inc.*, 311 F.3d 760, 765 (6th Cir. 2002))). The district court and the Third Circuit both affirmed. In adopting the "probability" standard of foreseeability under the WARN Act's unforeseeable business circumstances exception, the Third Circuit joined every circuit to have addressed the issue. *See, e.g., United Steel Workers of Am. Local* 2660, 683 F.3d 882, 887 (8th Cir. 2012); *Gross v. Hale-Halsell Co.*, 554 F.3d 870, 876 (10th Cir. 2009); *Halkias v. Gen. Dynamics Corp.*, 137 F.3d 333, 335 (5th Cir. 1998).

This standard, the court explained, "strikes an appropriate balance in ensuring that employees receive the protections the WARN Act was intended to provide without imposing an 'impracticable' burden on employers[.]" Third Circuit Opinion, at *10 (citing *Halkias* at 336). Companies in distress are often forced to make immediate, difficult choices, which "almost always involve the possibility of layoffs" if things go awry. *Id.* at *11. Further compounding the problem, an unnecessary layoff warning (such as a conditional warning) may actually accelerate a company's downfall and lead to personnel cuts that may have otherwise been avoidable. *Id.* That is the opposite result of what the WARN Act is meant to accomplish.

The Eclipse Layoffs Were Unforeseeable

Sixty days before the layoffs, the date that Eclipse was required to provide notice under the WARN Act, Eclipse was preparing to be sold on a going-concern basis at a bankruptcy court-approved auction. *Id.* ETIRC had been named the stalking-horse bidder, and it was still unclear whether additional bidders would materialize. *Id.* Accordingly, the court reasoned, failure of a sale could not be "probable" as of this date. *Id.* Nor could the failure of the sale be probable on the day the sale was approved by the bankruptcy court — less than a month before the layoffs occurred. *Id.*

The "more difficult question," according to the Third Circuit, was whether WARN Act liability was triggered at some point during the month between the approval of the sale and the layoffs. *Id.* The court noted that, while the repeated assurances, in hindsight, might appear to be nothing more than empty promises, the court was required to consider "the decisions Eclipse made based on the information available to it at the time and 'in light of the history of the business and of the industry in which the business operated.'" *Id.* at *12 (citation omitted).

The court emphasized that Eclipse and ETIRC had enjoyed a long-standing business relationship. *Id.* Moreover, ETIRC and its representatives demonstrated, through both their words and actions (*e.g.*, providing financial assistance and filling board seats), their intention to keep Eclipse operational following the sale. *Id.*

The "closer question," however, focused on the final three days before the employees were terminated. *Id.* Though the optimistic hope of a successful sale had faded, it was still not apparent that the delays in Moscow could not be resolved promptly. *Id.* Though the odds of the sale collapsing "may have reached fifty-fifty" while waiting on final authorization from Prime Minister Putin, the Eclipse board continued to receive credible assurances that such approval was forthcoming. *Id.* at *13. Accordingly, Eclipse was entitled to protection under the WARN Act's unforeseeable business circumstances exception, and could not be held liable for failing to warn its employees of the firm's eventual shutdown.

Lessons and Implications

A few aspects of *AE Liquidation* are not terribly surprising. The Third Circuit's adoption of the "probability" test simply joined every other circuit court of appeals that had considered the issue. And it likely comes as little surprise that the Third Circuit was unwilling to hold that, on the day the bankruptcy court approved the sale, it was "probable" that the sale would fail and the employees would be terminated. Thus, affirming summary judgment that no WARN Act notice was required through and including the date of the sale was somewhat of an easy call.

But what about during the February period — and especially the last three days — in which Eclipse was receiving (what turned out to be) empty promises? One is tempted to believe that the fact that Vladimir Putin and the Russian Parliament were involved weighed heavily on the Third Circuit's mind (and those of the courts below). The courts might well have been loath to fault the board of directors, and impose liability on the company, when the fault of not closing lies at the feet of the notorious dictator. If that is the true reasoning behind affirming summary judgment for the February time period, *AE Liquidation* might

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be of limited utility to future Chapter 11 debtors; it is unlikely that Putin will play a role in another 363 sale any time soon.

But the authors believe that the opinion can be read more broadly. It doesn't indicate on its face that the standard had been altered due to the unique character of Putin. Rather, the court seemed sympathetic to a board that demanded and was being given assurances, even though those assurances turned out to be meaningless in retrospect. The court specifically cited a policy rationale: a desire not to force a company to send a premature WARN Act notice, which could harm the very workers (by causing domino-effect harm to the company, leading to its demise) that the Act is meant to help. *Id.* at 10-11. That rationale suggests the expectation of a broad interpretation of the opinion.

Such an interpretation is good news for Chapter 11 debtors. Whether a debtor will actually close on a proposed section 363 sale is frequently in at least some doubt. If debtors were unable to rely on repeated assurances, the likelihood is that they would have to operate differently. Conditional WARN Act notices would become more frequently issued, and perhaps some value-maximizing (and job-saving) sales would simply be scuttled, with a debtor believing it could not pull off the sale while the workers are in disarray after receiving such a notice. Buyers, too, might be unwilling to close in such an environment. The court's holding that WARN Act notice did not even need to be given even in the February period means that debtors need not be so trigger-happy in issuing a notice.

That is not to say that *AE Liquidation* gives companies attempting a sale carte blanche to ignore the WARN Act. The court credited the evidence that the board of directors met frequently, weighed the probability of closing at various times, and took specific action in making demands and setting drop-dead dates. In other words, it created a good record to defend its actions. Debtors who face uncertainty that a sale will close and are concerned about WARN Act liability are well advised to create a similar record in future cases.

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