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A recent decision by the Court of Appeals for the Second Circuit, *Guippone v. BH S&B Holdings LLC,* serves as a **warning** to private equity investors and lenders that they should be careful to observe corporate formalities and distance themselves from the employment decisions of their portfolio companies. Otherwise, such **investors and lenders may face liability for the portfolio company's violation of employment laws**, including the Worker Adjustment and Retraining Notification Act ("**WARN**").

WARN requires covered employers to provide employees with 60 calendar days' notice of plant closings and mass layoffs. Failure to comply with WARN can result in liability to each affected employee for back pay and benefits. A plaintiff may have a strong incentive to claim that an investor or lender is liable under WARN, since the direct employer may be insolvent at the time of the plant closing or mass layoff.

To avoid potential liability, **the *Guippone* case highlights the importance of implementing and observing corporate formalities** with respect to a portfolio company. In *Guippone,* Steve & Barry's management notified the investor that due to the store's financial trouble, it needed to lay off workers. The investor's board passed a resolution stating that it received this notice from Steve & Barry's management and authorized Steve & Barry's to carry out the layoff. In the resolution, the investor specifically noted that notice should be given to each affected employee as soon as reasonably practicable and in consideration of any applicable law. Former Steve & Barry's employees affected by the layoff brought suit against the Company and the investor on the basis that they did not receive proper notice under WARN Act.

The Court applied the Department of Labor ("DOL") regulations to determine whether the investor could be liable under the WARN Act. **The test under DOL regulations determines the portfolio company's degree of independence from the respective investor** based on the following factors:

- common ownership;
- common directors and/or officers;
- de facto exercise of control;
- unity of personnel policies emanating from a common source; and
- dependency of operations.

The Court held that a jury could reasonably find that the investor exercised control over Steve & Barry's and was therefore liable under the WARN Act, highlighting that **exercise of control alone could be sufficient to justify liability for the investor**. The Court focused on the fact that the investor's board had issued a resolution *authorizing* the layoff which could be interpreted as a *direction* from the investor to carry out the layoff. The Court also noted that Steve & Barry's did not have its own board and the investor and Steve & Barry's shared common officers. Further, the Court noted that the investor's board exercised control by choosing the Steve & Barry's management team.

Like investors, in order to avoid potential liability, **lenders should** also be careful to **preserve their borrowers' independence** and to avoid meddling in employment related decisions. The Second Circuit has held that a lender is liable under the WARN Act for its borrower's missteps when it "becomes so entangled with its borrower that it has assumed responsibility for the overall management of the borrower's business." *Coppola v. Bear Stearns & Co.* 499 F.3d 144, 150 (2d Cir. 2007). The Eighth and the Ninth Circuits have also looked at investor and lender liability and, like the Second Circuit, apply the DOL regulations test for investors, but apply a similar, more lenient, standard for lenders. The Third and Fifth Circuits, on the other hand, apply the DOL regulations test for both

lenders and investors. The trend in recent case law appears to favor the more stringent DOL regulations test for both investors and lenders.

The *Guippone* case is an important reminder that where corporate formalities are not carefully observed, courts will likely look past the company's separate corporate form and hold investors and lenders liable under relevant employment laws, including the WARN Act. Courts have also found **exercise of control** over a portfolio company **to create investor or lender liability under other employment laws, including the Fair Labor Standards Act, Title VII of the Civil Rights Act of 1964, and the National Labor Relations Act**. To reduce potential liability, investors and lenders should diligently follow best practices related to corporate governance and corporate separateness and make sure they have refrained from participating directly in operating-level decisions, particularly when the portfolio company or borrower is financially challenged.

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