

BY SCOTT A. WOLFSON AND ANTHONY J. KOCHIS

## Golden Guernsey: A WARNing to Directors and Officers

Unsecured creditors have another potential source of recovery against directors and officers (D&Os), and D&Os of distressed companies have more to worry about following the U.S. Bankruptcy Court for the District of Delaware's decision in *Stanziale v. MILK072011 LLC (In re Golden Guernsey Dairy LLC)*.<sup>1</sup> The court held that officers could be personally liable for failing to provide appropriate advance notice of a layoff to the debtor's employees under Wisconsin's version of the Worker Adjustment and Retraining Notification (WARN) Act.<sup>2</sup> The WARN Act provides for recourse directly against only the "employer" as a remedy,<sup>3</sup> but the chapter 7 trustee sought to hold the officers of the debtor personally liable for the violation on breach-of-fiduciary-duty grounds.<sup>4</sup> This article provides a brief overview of the fiduciary duties at issue in *Golden Guernsey Dairy* and the WARN Act, followed by an analysis of the decision and its potential implications beyond its statutory and procedural context.



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### Fiduciary Duties of Care and Loyalty

The *Golden Guernsey Dairy* court had to determine whether the trustee's complaint stated a claim for breach of fiduciary duties against the debtor's officer and former officer. Once appointed as a director or officer of a corporation or limited liability company, D&Os owe fiduciary duties to the company. While the specific obligations of D&Os depend on state law and the form of the entity, fiduciary duties generally include a duty of loyalty and duty of care.<sup>5</sup> "Duty of care" includes the obligation to exercise the same degree of care that an ordinarily careful and prudent person would use in the same or similar circumstances while acting rationally, after pursuing a deliberate investigation of all material information that is reasonably available at the time, and after carefully considering the information and reasonable alternatives available at the time.<sup>6</sup>

Fiduciaries breach their duty of loyalty by intentionally failing to act in the face of a known duty to

act, demonstrating a conscious disregard for their duties.<sup>7</sup> A fiduciary acts in bad faith when, among other things, the fiduciary takes or fails to take any action that demonstrates a faithlessness or lack of true devotion to the interests of the corporation and its shareholders.<sup>8</sup>

D&Os enjoy a level of protection in their decision-making, so long as the "business-judgment rule" applies. In these circumstances, a court will not second-guess an action by a D&O that was made on an informed basis, with an honest belief that the action was in the best interests of the corporation and without conflicts of interest.<sup>9</sup>

Who may enforce fiduciary duties changes as a corporation slides into insolvency. When solvent, fiduciary duties might be enforced by the corporation or equityholders through a derivative standing. When insolvent, the corporation continues to have standing to enforce fiduciary duties, and in some circumstances, creditors of the insolvent corporation may enforce fiduciary duties through derivative standing. In the context of a chapter 7 case like *Golden Guernsey Dairy*, the chapter 7 trustee has standing to enforce fiduciary duties.

### WARN Act

Many states have mini-WARN Acts, such as Wisconsin's,<sup>10</sup> which was at issue in *Golden Guernsey Dairy*. The WARN Act requires employers to provide notice to employees of plant shutdowns or layoffs in certain circumstances, and governs only employers with a workforce of 100 or more employees.<sup>11</sup> If the WARN Act notice requirement is triggered and a notice exception does not apply, an employer must give 60 days' notice to all affected employees or their representatives, as well as the state and local governments.<sup>12</sup> The WARN Act does not require notice upon every shutdown or layoff; rather, an employer must give notice if there is a permanent or tem-

1 2015 Bankr. Lexis 3185 (Bankr. D. Del. Sept. 21, 2015). The authors thank **Robert J. Feinstein** (Pachulski Stang Ziehl & Jones LLP; New York) for bringing this case to their attention.

2 29 U.S.C. §§ 2101-2109.

3 29 U.S.C. § 2104.

4 *Stanziale*, 2015 Bankr. Lexis at \*5.

5 A number of other duties are subsumed within the duty of loyalty and care, such as the duty of disclosure.

6 See, e.g., *Official Comm. of Unsecured Creditors v. Bay Harbour Master Ltd. (In re BH S&B Holdings LLC)*, 420 B.R. 112, 146 (Bankr. S.D.N.Y. 2009) (citing Delaware law).

7 *Bridgeport Holdings Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings Inc.)*, 388 B.R. 548, 564 (Bankr. D. Del. 2008) (citing Delaware law).

8 *Id.* (quotation omitted).

9 *Continuing Creditors' Comm. of Star Telecomms. Inc. v. Edgcomb*, 385 F. Supp. 2d 449, 462 (D. Del. 2004) ("Under Delaware law, the business-judgment rule operates as a presumption 'that directors making a business decision, not involving self-interest, act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest.'" (quoting *Grobov v. Perot*, 539 A.2d 180, 187 (Del. 1988)).

10 See Wis. Stat. §§ 109.07, 109.075.

11 29 U.S.C. § 2101.

12 29 U.S.C. § 2102.

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porary shutdown resulting in a loss of 50 or more employees during any 30-day period or a mass layoff of at least 500 employees or 33 percent of its workforce.<sup>13</sup> There are exceptions to WARN Act notification, such as the “unforeseeable business circumstances” exception, where failure to give notice does not expose an employer to liability if there is an unforeseeable circumstance and if the layoffs were caused by the unforeseeable circumstance.<sup>14</sup>

In the event that an employer fails to give notice as required by the WARN Act, an affected employee may bring a civil action against the employer.<sup>15</sup> The employer will be liable for back pay and benefits for each day of the violation.<sup>16</sup> The employer will also be subject to a civil penalty of not more than \$500 for each day that the local government does not receive notice as required by the WARN Act.<sup>17</sup> The WARN Act does not provide for personal liability of directors, officers or employees — only the employer.

### Trustee States Claim for Breach of Fiduciary Duties for Failure to Comply with WARN Act

Golden Guernsey Dairy LLC operated a dairy and milk-processing facility in Wisconsin. It ceased operating on Jan. 5, 2013, and filed chapter 7 on Jan. 8, 2013.<sup>18</sup> The Wisconsin Department of Workforce Development filed a proof of claim on behalf of some of the debtor’s former employees, claiming damages of approximately \$1.56 million under Wisconsin’s WARN Act.<sup>19</sup> The chapter 7 trustee filed a complaint against the debtor’s sole member, former manager and former president alleging breach of fiduciary duties for exposing the debtor to the WARN Act claims.

The defendants filed a motion to dismiss the complaint, arguing that the trustee’s claim was barred because the creditors lacked standing under Delaware law to bring claims for breaches of fiduciary duty.<sup>20</sup> The defendants also argued that the trustee’s claim was barred because the claim was, in essence, a “deepening insolvency” claim, and that such claims have been rejected by Delaware courts.<sup>21</sup> While the debtor’s liabilities may have increased as a result of the claimed WARN Act violation, the defendants contended that the debtor was insolvent before the WARN Act violation and became only more insolvent as a result of the WARN Act violation.

The bankruptcy court held that the trustee’s breach-of-fiduciary-duties claim was viable, and that the trustee had standing to assert the claim. First, the court noted that a failure to act in the face of a known duty to act constitutes a

breach of a D&O’s duty of loyalty.<sup>22</sup> The trustee alleged that the defendants ignored their responsibility to give appropriate WARN Act notice and exposed the debtor to resulting WARN Act liability. Second, the court held that it did not matter whether the trustee’s breach-of-fiduciary-duty claim was a direct claim or a derivative claim because the trustee was charged with pursuing the estate’s assets and was the “sole representative of the estate with the authority to sue and be sued.”<sup>23</sup> Therefore, in the context of a motion to dismiss where well-pleaded factual allegations are accepted as true, the court held that the alleged facts supported a finding that the defendants breached their fiduciary duties by exposing the debtor to claims under the Wisconsin WARN Act.

**[Golden Guernsey Dairy] is yet another reminder to D&Os about the importance of adequate insurance coverage.**

The procedural posture of the *Golden Guernsey Dairy* case is important; the court held that the trustee pled sufficient facts to state a claim for relief that survived a motion to dismiss for failure to state a claim. The trustee maintained the burden to establish all elements of his cause of action at trial. Nonetheless, the decision has possible wide-ranging implications.

### Implications

*Golden Guernsey Dairy* provides an unequivocal reminder to D&Os of troubled companies to take extra care to ensure that WARN Act notices are appropriately given. But the case could have much broader implications beyond the WARN Act.

The D&Os in *Golden Guernsey Dairy* faced personal liability because their company failed to comply with a statute, resulting in the company’s liability for damages due to the violation. The trustee alleged that the D&Os breached their fiduciary duties by failing to cause the company to comply with the statute. The scenarios in which such a claim could be brought are limited only by the statutes or ordinances — state, federal and local — that may have subjected, or are alleged to have subjected, a debtor to liability. These may include civil rights statutes addressing harassment and other discrimination in the workplace; nuisance laws; tax penalties; wage laws; securities laws; zoning ordinances; commission statutes; labor laws; and fraudulent transfer laws.

*Golden Guernsey Dairy* suggests that estate representatives, including debtors in possession, trustees, and potentially creditors’ committees (given their ability to obtain derivative standing), should determine whether the debtor

13 *Id.*

14 *Id.*; *Richards v. Advanced Accessory Sys. LLC (In re Advanced Accessory Sys. LLC)*, 443 B.R. 756, 763 (Bankr. E.D. Mich. 2011) (“To satisfy the ‘unforeseeable business circumstances’ exception, the party asserting the defense must establish that: (1) the circumstance was unforeseeable; and (2) the layoffs were caused by that circumstance.”).

15 29 U.S.C. § 2104.

16 *Id.*

17 *Id.*

18 *Stanziale*, 2015 Bankr. Lexis at \*3.

19 *Id.*

20 *Id.* at \*5.

21 *Id.* at \*6-7.

22 *Id.* at \*7 (quoting *In re Bridgeport Holdings Inc.*, 388 B.R. 548, 564 (Bankr. D. Del. 2008)).

23 *Id.* at \*6 (quoting *In re USDigital*, 443 B.R. 22, 43 (Bankr. D. Del. 2011)).

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has been held liable (or is alleged to be liable) for damages under a statute. If there are colorable facts that the D&Os may have failed to properly act in the face of a potential statutory liability, the estate representative should consider bringing a claim for breach of fiduciary duties and, at a minimum, provide notice of circumstances to the debtor's insurance carrier to preserve any potential coverage while the investigation is being completed. An estate representative's failure to investigate potential liability of D&Os for causing statutory damages could itself be argued to be a breach of the estate representative's fiduciary duties in light of *Golden Guernsey Dairy*.

### **Conclusion**

The straightforward implications of *Golden Guernsey Dairy* are two-fold. First, D&Os must be mindful of the

WARN Act and mini-WARN Acts when contemplating a bankruptcy filing. Second, when representing a distressed company, D&Os should be advised about potential personal liability in connection with a failure to comply with the WARN Act on breach-of-fiduciary-duty grounds.

Extrapolating from *Golden Guernsey Dairy*, D&Os of a distressed company face potential liability any time the company they serve violates a law that results in a financial penalty. This case is yet another reminder to D&Os about the importance of adequate insurance coverage.

It is too soon to determine whether *Golden Guernsey Dairy* will result in an increase in litigation against D&Os. Given the dearth of assets in most chapter 11 filings, D&Os can only expect the scrutiny of their prebankruptcy actions (or failure to take action) to intensify. **abi**

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