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Repercussions of the Collision of Labor Law and Health Care Industry Bankruptcies

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Intensive Care II

Labor laws, although applicable to most businesses, may wreak particular havoc in the restructuring of a health care business under the Bankruptcy Code. Labor law issues in health care business cases are perhaps more important than in other kinds of cases because the industry is labor intensive and growing,[2] and represents a significant national employer on a macro-level.[3] Among the many labor law-related traps waiting for a health care business entering bankruptcy are liability under the Worker Adjustment and Retraining Notification Act (WARN Act)[4] and issues associated with the rejection of collective-bargaining agreements (CBAs). Two recent decisions in the U.S. Bankruptcy Court for the Central District of California illustrate how these issues may be resolved.

Liquidating Hospitals and the WARN Act

The WARN Act generally requires any "employer" of 100 or more employees to provide 60 days advance written notification before any "mass layoff."[5] The WARN Act defines an employer as "any business enterprise that employs 100 or more employees." Although the statute fails to define "business enterprise," the pertinent Department of Labor comment explains that a "fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit of creditors does not succeed to the notice obligations of the former employer because the fiduciary is not operating a 'business enterprise' in the normal commercial sense."[6] Damages for violations of the WARN Act are calculated as up to 60 days of the covered employee's pay, plus civil penalties of $500 per day.[7] Thus, for a large hospital, with a relatively highly compensated staff,[8] this liability could represent a significant sum. Moreover, under some circumstances, that sum may become an administrative claim,[9] significantly changing the calculus of the bankruptcy process. Two cases from more than a decade ago have established the framework for evaluating a debtor's liability under the WARN ACT in the context of a chapter 11 case where the debtor is liquidating: *In re United Healthcare Systems Inc.*[10] and *In re Jamesway Corp.*[11]

In *United Healthcare*, the Third Circuit held that a debtor-hospital was not liable for back pay to employees under the WARN Act, where the debtor-hospital filed a chapter 11 petition 16 days before it laid off 1,200 of its 1,300 employees.[12] The court of appeals reasoned that whether a chapter 11 debtor in possession (DIP) is an "employer" for purposes of the WARN Act depends on the "nature and extent of the entity's business and commercial activities while in bankruptcy, and not merely on whether employees continue to work 'on a daily basis.'"[13] The court of appeals found that a "liquidating fiduciary" was

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2 "Ten of the 20 Fastest Growing Occupations Are Healthcare Related," Bureau of Labor Statistics, U.S. Department of Labor, *Career Guide to Industries, 2010-2011 Edition, Healthcare* (BLS Career Guide), at 1, available at www.bls.gov/oco/cg/cgs035.htm (last visited July 28, 2010).

3 "As one of the largest industries in 2008, healthcare provided 14.3 million jobs for wage and salary workers." *Id.* Additionally, "[h]ealthcare will generate 3.2 million new wage and salary jobs between 2008 and 2018, more than any other industry, largely in response to rapid growth in the elderly population." *Id.* at 7.

4 29 U.S.C. § 2101, *et seq.*

5 *Id.* at § 2101.

6 54 Fed. Reg. 16,042, 16,045 (1989).

7 29 U.S.C. § 2104(a).

8 BLS Career Guide, at 9 ("Average earnings of nonsupervisory workers in most healthcare segments are higher than the average for all private industry, with hospital workers earning considerably more than the average.").

9 *See In re Hanlin Group Inc.*, 176 B.R. 329 (Bankr. D. N.J. 1995) (finding WARN Act claims asserted by employees who were terminated post-petition entitled to priority status); *but see In re Jamesway Corp.*, 235 B.R. 329 (Bankr. S.D.N.Y. 1999) (finding employees terminated post-petition were not entitled to administrative-expense priority status because employer's WARN Act notice obligation arose pre-petition).

10 *In re United Healthcare Systems Inc.*, 200 F.3d 170 (3d Cir. 1999).

11 *In re Jamesway Corp.*, 235 B.R. 329 (Bankr. S.D.N.Y. 1999).

12 *United Healthcare*, 200 F.3d at 172.

13 *Id.* at 178.

not an "employer," which the WARN Act defines as a "business enterprise."[14]

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By contrast, the *Jamesway* court granted summary judgment finding the "liquidating fiduciary" debtor liable as an employer under the WARN Act.[15] The court noted that although the status of "liquidating fiduciary" could relieve a DIP from WARN Act liability, in this case the debtor (1) decided to liquidate, (2) identified which employees would be terminated, (3) planned the schedule for the layoffs and (4) proceeded to terminate the laid-off employees a full six days before filing its chapter 11 petition. The court found that the employer was liable under the WARN Act prior to the chapter 11 filing because the employees became entitled to notification at the time of these events.[16] As with so many things, timing is everything.

Although these cases deal with a liquidation under chapter 11, this issue was recently addressed in the context of a chapter 7 liquidation in *In re Century City Doctors Hospital LLC.*[17] In *Century City Doctors Hospital*, the bankruptcy court found that, under the facts of the case, the chapter 7 trustee was not acting as an "employer" within the meaning of the WARN Act, and was not subject to its requirements in causing layoffs of the debtor's employees without the required notification,[18] even though the trustee operated the business of the debtor-hospital for approximately one week following the filing of the petition.[19] The court reasoned that the trustee operated the business for the limited purpose of shutting down the debtor's operations and complying with government regulations relating to disposal of medical waste and hazardous materials, with the intention of closing the facility at the earliest reasonable time and liquidating its assets for the benefit of creditors.[20] The court found that the trustee acted solely as a liquidating fiduciary, rather than as an employer operating a business enterprise in the normal commercial sense.

The court's decision was not predicated on either the status of the trustee under chapter 7 or on how long the business remained in operation, but rather on the nature of the operations. The court noted that the trustee did not operate the business "in the normal commercial sense."[21] Had the trustee operated the hospital "for business purposes" for even a short period of time, the decision might well have been different. In fact, the court stated, "it appears possible that a WARN Act claim could be properly asserted if a chapter 7 trustee were to continue to operate a business for a period of time."[22]

Thus, it is critical for the debtor and counsel to closely analyze any prospective layoffs or hospital closures in light of the WARN Act. When hospital closures and "mass layoffs" are necessary, it is critical to consider the timing of not merely the layoffs themselves, but the planning as well. Substantial risk exists for an estate that plans significant employment terminations while still operating as a business enterprise, not purely as a liquidating fiduciary.

Liquidating Hospitals and Rejection of CBAs

Despite the seeming importance of unions serving the health care industry such as the Service Employees International Union (SEIU) and the United American Nurses-National Nurses Organizing Committee, the health care industry is not heavily unionized.[23] However, hospitals are the kind of health care business most likely to be unionized,[24] and even though they represent only 1.3 percent of all health care industry establishments, they employ almost 35 percent of all health care industry workers.[25] Thus, the impact of a debtor's effort to reject a CBA can be important in one's efforts to liquidate the assets of a hospital, particularly if the prospective purchaser does not want to take the assets encumbered by the CBA.

Section 1113 of the Bankruptcy Code requires debtors, prior to seeking rejection of a CBA, to make a proposal to the union accompanied by sufficient information to permit proper evaluation of the proposal.[26] A bankruptcy court may approve rejection of the CBA if it finds that (1) the debtor made a proposal that meets the statutory requirements of § 1113(b), (2) the union rejected the proposal without good cause and (3) the balance of equities clearly favors rejection of the CBA.[27] The majority of courts utilize a nine-part test to make the determination: (1) the debtor must make a proposal to the union to modify the CBA; (2) the proposal must be based on the most complete and reliable information available; (3) the proposed modifications must be necessary to permit the reorganization of the debtor; (4) the proposed modifications must assure that the debtor and all affected parties are treated fairly and equitably; (5) the debtor must provide the union such relevant information as is necessary to evaluate the proposal; (6) between the time of the making of the proposal and the time of the hearing, the debtor must meet at reasonable times with the union; (7) at the meeting, the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the CBA; (8) the union must have refused to accept the proposal without good cause; and (9) the balance of the equities must clearly favor rejection.[28] As to each of the nine prerequisites for rejection of the CBA, debtors bear the burden of proof,[29] but once that burden has been met, the union must produce some evidence to show that it was not provided with relevant information, that the debtor did not bargain in good faith, and that the union's refusal to accept the debtor's modification proposal was not without good cause.[30]

In the chapter 11 case of *In re Karykeion Inc., d/b/a Community and Mission Hospitals of Huntington Park*, currently pending in the Central District of California, the bankruptcy court was recently forced to review the application of § 1113 in the context of the liquidation of a chapter 11 debtor that had been operating two acute-care hospitals. Because chapter 11 cases frequently include either the liquidation of assets through a sale under § 363 or through confirmation of a liquidating plan of reorganization pursuant to § 1129, the case is interesting in that it evaluates what a debtor must do when liquidating to satisfy § 1113 when the buyer is seeking to acquire the hospital *without* its CBAs.

At the time of filing its chapter 11 case, the debtor was a party to CBAs

14 29 U.S.C. § 2101(a)(1).
15 *Jamesway*, 235 B.R. at 335.
16 *Id.* at 343-44.
17 417 B.R. 801 (Bankr. C.D. Cal. 2009).
18 *Id.* at 802.
19 *Id.* at 805.
20 *Id.*
21 *Id.*
22 *Id.* at 804.
23 BLS Career Guide, *supra*, n.1, at 10.
24 BLS Career Guide, *supra*, n.1, at 10 ("In 2008, 17 percent of workers in hospitals were members of unions or covered by union contracts, while all other healthcare sectors had rates below the 14 percent average for all industries.").
25 BLS Career Guide, *supra*, n.1, at 2, Table 1.
26 *In re Maxwell Newspapers Inc.*, 146 B.R. 920 (Bankr. S.D.N.Y.), *aff'd in part and rev'd in part*, 149 B.R. 334 (S.D.N.Y.), *rev'd*, 981 F.2d 85 (2d Cir. 1992).
27 11 U.S.C. § 1113(c); *see Maxwell Newspapers Inc., supra.*
28 *See, e.g., In re National Forge Co.*, 289 B.R. 803 (Bankr. W.D. Pa. 2003); *In re Alabama Symphony Ass'n*, 155 B.R. 556, 573 (Bankr. N.D. Ala. 1993); *In re Bowen Enterprises Inc.*, 196 B.R. 734 (Bankr. W.D. Pa. 1996); *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984) (all discussing in detail this widely accepted nine-part test).
29 *Bowen Enterprises, supra*, 196 B.R. at 741.
30 *American Provision Co., supra*, 44 B.R. at 910.

with SEIU and the California Nurses Association (CNA). Both CBAs had provisions that required the debtor to ensure that a new employer would retain the bargaining-unit employees, recognize the union and assume the CBAs (usually referred to as "successorship provisions"). By the time the motion to reject the CBAs was filed, the debtor's CBA with SEIU had expired by its own terms, but its CBA with CNA was still extant.

The debtor entered into a memorandum of understanding (MOU) to sell the hospital, which required the debtor to reject both of the CBAs. After signing the MOU, the debtor provided a copy of the MOU to the unions' attorneys and met with the unions' representatives, among other things, to explain the sale process, and then, within a month, filed a motion to reject the CBA pursuant to § 1113. At the three meetings with the unions, the debtor's chief reconstructing officer (CRO) explained that he had tried to make the buyer assume the CBAs, but the buyer refused. The union made certain offers to the CRO, all of which were rejected by the buyer. During this same timeframe, the CRO testified that the debtor's cash reserves were nearing the point at which sufficient funds might not be at hand to close down the hospital without risk to patients. In fact, the buyer was forced to make a bridge loan to the debtor to enable it to operate until the purchase of the hospital could be closed. After a seven-hour evidentiary hearing, the bankruptcy court granted the debtor's motion to reject the CBAs.

First, the court disagreed with the SEIU's contention that the court lacked jurisdiction to modify an expired CBA because jurisdiction lay exclusively with the National Labor Relations Board (NLRB). Finding conflicting case law in other jurisdictions and that decisions by the Bankruptcy Appellate Panel for the Ninth Circuit (BAP) were non-binding *dicta*, the court looked to the language of § 1113, the legislative history surrounding § 1113 and the BAP's statements, and concluded that the purpose of § 1113 was to allow a debtor "to terminate or modify its ongoing obligations to its organized workforce, whether those obligations arise as a result of a current *or expired* CBA."[31]

The court then concluded that, although the Ninth Circuit had never specifically adopted the nine-step approach, that analysis was appropriate. The court found that (1) a proposal had been made, (2) it had been based on as complete and reliable information as could be obtained in a severely distressed situation with changing information, (3) the modification was necessary because the buyer would not purchase the hospital without rejection of the CBAs, (4) despite the shared "pain," the modification would treat all parties fairly and equitably, (5) the unions had the relevant information necessary to evaluate the proposal, "sufficient in light of when things were definite and how fast things were moving," (6) the debtor had met with workers at reasonable times,[32] (7) the debtor had conferred in good faith,[33] (8) the unions did not show adequate cause for refusing the debtor's proposal, having made no counterproposal on the successorship provision[34] and (9) the balance of the equities clearly favored rejection because if the buyer walked away, the debtor would liquidate and only secured creditors would see any recovery, all employees would lose their jobs and the hospital would close.

Conclusion

Hospitals are labor-intensive entities, and labor law issues can have an important impact on efforts to maximize the return to creditors, whether in chapter 7 or 11. These two decisions show that there are still new issues to be decided and that old issues can re-surface in different contexts. As hospitals deal with the uncertainty created by national health care reform the risk of financial issues-and labor difficulties can only increase, so counsel should expect to hear more of these issues in the future. ■

31 Memorandum of Decision, Case No. I 1:08-bk-17254-MT, at 14 [Docket No. 957] (emphasis added).

32 To the argument that the workers should have been afforded more reasonable time to negotiate with the buyer, the court noted as follows: "Section 1113 does not require the debtor to engage in futile acts—[the buyer] would not meet with the unions and [CRO] was clearly making no progress with getting [the buyer] to accept any of either his or the unions' ideas on how to get any part of the CBAs accepted by [the buyer]...the decision of a CRO not to spend hours in fruitless negotiations was not unreasonable." *Id.* at 26.

33 The court addressed the debtor's good faith as follows: "The Unions are correct that beginning negotiations when one party is already locked into a position does not constitute good faith... This [sic] debtor was, however, not locked in. This situation differs from Lady H Coal both because the debtor passed the unions offers along to [buyer], tried to negotiate further with [buyer] on behalf of the unions, and the debtor only signed a MOU with [buyer] before negotiating under 1113, not an asset purchase agreement. The MOU states...that except for [three] sections inapplicable here, the MOU did not create 'any binding legal obligations between the Parties, and each Party reserves the right to approve the definitive Agreement and to address the results of any diligence in connection with developing a definitive Agreement.' Significantly, the creditor's committee was still providing information to 'Rose Avenue,' as unlikely as that potential bid appeared to be. No break up fee to [buyer] was ever approved, nor was pre-approval sought by the debtor." *Id.* at 27.

34 The court held as follows: "While the unions cannot be expected to accept a proposal which rejects their entire CBA, the debtor did offer a reasonable accommodation that was above what employees would receive had it just closed down. The proposal the debtor made was the best it could do under circumstances where [the buyer] would not agree to more, and any rejection of that proposal means that a chance to keep the hospital open to benefit could fail." *Id.* at 30.

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