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As Corporate Bankruptcies Rise, So Do Lawsuits Against Managers

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In today's difficult economic climate, a growing number of companies have been forced to consider or even file for bankruptcy. Such filings may result in a stay of legal claims against the company, including those brought by current or former employees under the Fair Labor Standards Act (FLSA). But according to the Ninth Circuit, a company's filing for bankruptcy does not protect its individual executives and managers from potential liability under the FLSA.

In *Boucher v. Shaw*, 572 F.3d 1087 (9th Cir. 2009), three former employees and their union brought claims for unpaid wages under the FLSA and Nevada state law against the CEO, CFO and a manager responsible for handling labor and employment matters for the Castaways Hotel, Casino and Bowling Center ("the Castaways"). The Castaways had filed for Chapter 11 bankruptcy protection, but later ceased operations, discharged the plaintiffs, and converted their bankruptcy to a Chapter 7 liquidation. The district court dismissed the plaintiffs' claims, and the plaintiffs appealed. After certifying the state law question to the Nevada Supreme Court, which held that the individual managers could not be held personally liable as "employers" under relevant Nevada law, the Ninth Circuit then addressed whether the individual managers could be held liable as "employers" under the FLSA despite the Castaways' bankruptcy.

It is well settled that individual executives and supervisors can face personal liability under the FLSA, whose definition of an "employer" includes "any person acting directly or indirectly in the interest of an employer in relation to an employee." 29 U.S.C. § 203(d). Generally, mere status as a company's owner or majority shareholder is insufficient to create an "employer" status under the FLSA where there is no evidence of involvement in day-to-day operations or responsibility for supervision of the employees at issue. *See Perez v. Sanford-Orlando Kennel Club, Inc.*, 515 F.3d 1150 (11th Cir. 2008). Most courts use some version of the "economic realities" test to determine whether a particular executive or supervisor meets the FLSA's definition of employer, focusing on factors such as the individual's ownership interest, degree of control over the corporation's financial affairs and compensation practices, power to hire and fire employees, supervision or control over employee work schedules and conditions of employment, maintenance of employment records, and role in causing or not causing the company to compensate employees in compliance with the FLSA. *See, e.g., Chao v. Hotel Oasis, Inc.*, 493 F.3d 26 (1st Cir. 2007).

In *Boucher*, the individual defendants did not argue that they were not "employers" within the meaning of the FLSA. Rather, they claimed that any duty they had to pay wages to Castaways' employees ended with the conversion of Castaways' Chapter 11 bankruptcy proceeding into a Chapter 7 liquidation. The Ninth Circuit disagreed, noting that the conversion of the Castaways' bankruptcy to a Chapter 7 liquidation had occurred after the plaintiffs' pay became due. The Court further indicated that it would not have mattered whether the Castaways was in Chapter 11 or Chapter 7 bankruptcy, since the Castaways was not a defendant and the defendants were not debtors. Thus, an automatic stay intended to protect the debtor could not affect the plaintiffs' claims.

It should be noted that the Court in *Boucher* suggested that the result may have been different if the defendants' liability somehow affected the property of the bankruptcy estate. If Castaways had been required to indemnify the executives and manager, or if any judgment against the defendants were payable from a Directors and Officers insurance policy, the plaintiffs may have been required to proceed against the

defendants through bankruptcy proceedings. Thus, employers and senior managers may want to consider the potential for managers' personal liability when structuring employment agreements, making decisions about insurance coverage for executives, and contemplating a bankruptcy filing.

Do not be surprised to see the *Hunter* case appealed to the Supreme Court. Of particular focus in such an appeal may be the Sixth Circuit's reliance in *Hunter* upon an administratively-promulgated regulation—rather than Congressional intent like the Supreme Court did in *Gross*—to buttress its holding. Baker Donelson can assist you with these and other employment-related challenges. For assistance, please contact your Baker Donelson attorney or any of our nearly 70 Labor & Employment attorneys located in *Birmingham, Alabama; Atlanta, Georgia; Baton Rouge, Mandeville* and *New Orleans, Louisiana; Jackson, Mississippi;* and *Chattanooga, Johnson City, Knoxville, Memphis and Nashville, Tennessee*.

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