



BANKRUPTCY LAW ALERT

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Pennsylvania District Court Rules that the Automatic Stay does not Apply to Actions by the United States Department of Labor Under the Fair Labor Standards Act

A recent decision in the District Court, Western District of Pennsylvania (Hornak, D.C.J.) held that the automatic stay under § 362 of the Bankruptcy Code did not operate to stay an action brought by the United States Department of Labor (“DOL”) under the Fair Labor Standards Act (“FLSA”).

The automatic stay provisions of § 362 of the Bankruptcy Code represent a fundamental benefit of the bankruptcy process. Invariably, both the necessity and timing of any bankruptcy filing are driven by the application and enforcement of the automatic stay, to prevent entry of a judgment, enforcement of rights in collateral, lease termination, or similar catastrophic business event. One significant exception to the stay is the enforcement of police and regulatory powers pursuant to § 362(b)(4).

In *Stewart v. Holland Acquisitions, Inc.*, 2021 WL 1037617, the DOL alleged that the defendants, repeatedly and willfully, violated provisions of the FLSA by failing to compensate employees for overtime, and failing to maintain and preserve adequate records of its employees of wages, hours and other conditions of employment. The action sought both injunctive relief and a judgment against the defendants for back wages, liquidated damages and related damages pursuant to the FLSA.

In February 2021, almost six years after commencement of the litigation, defendant Holland Acquisition, Inc. filed a Chapter 11 bankruptcy case, and advised the District Court that it had filed for bankruptcy protection. The defendants alleged that the bankruptcy filing operated to stay the DOL action and sought to extend the stay to the non-debtor defendant principal. The DOL argued that the pending action fell within the “police and regulatory” exception to the automatic stay pursuant to § 362(b)(4), that the automatic stay:

does not operate as a stay . . . of the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit’s . . . police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit’s . . . police or regulatory power[.]



The defendants argued that § 362(b)(4) did not apply to claims under the FLSA relying upon the Sixth Circuit's decision in *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001) alleging that the DOL's claims against the defendants were not covered by the police power exception to the automatic stay because it seeks primarily to protect private rights of certain individuals.

After careful consideration of the Sixth Circuit's decision in *Hospital Services*, Chief Judge Hornak rejected the defendants arguments stating that, "...to extend the automatic stay as to prevent the Secretary from seeking an entry of judgment for back wages and liquidated damages, hand in hand with prospective injunctive relief, all as part and parcel of the Secretary of Labor's enforcement of the FLSA by federal court litigation, would likewise substantially impair the core remedial purposes of the FLSA." Chief Judge Hornak further stated that the action sought an equitable judgment permanently enjoining and restraining any future violations of the FLSA by the defendants and that the characterization of the action by the defendants "inaccurately minimizes both the litigation role of the Secretary of Labor under the FLSA and the purposes of such litigation in ways that neither the FLSA nor the bankruptcy code provide or require."

The Third Circuit has not ruled on this issue. As of the date of this Alert, no appeal of the decision had been filed in the District Court. In the meantime, entities and individuals facing FLSA claims (and other enforcement action by regulatory agencies) must carefully review the parties, claims asserted, and relief sought to determine whether a bankruptcy filing will provide the necessary relief.

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