STRADLEY RONON

Client Alert

WWW.STRADLEY.COM

APRIL 5, 2021

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

www.meritas.org

Stradley Ronon is a member of Meritas, the premier global alliance of independent law firms. Meritas firms offer a full range of legal services to meet every client need.

Information contained in this publication should not be construed as legal advice or opinion or as a substitute for the advice of counsel. The enclosed materials may have been abridged from other sources. They are provided for educational and informational purposes for the use of clients and others who may be interested in the subject matter.

Copyright © 2021
Stradley Ronon Stevens & Young, LLP
All rights reserved.

Employers Should Take Note of a Recent District Court Decision Holding that the U.S. Bankruptcy Code’s Automatic Stay Does Not Extend to FLSA Enforcement Actions

In a recent decision from the United States District Court for the Western District of Pennsylvania, the court held that the U.S. Bankruptcy Code’s automatic stay does not extend to enforcement actions brought by the U.S. Department of Labor (DOL) under the Fair Labor Standards Act (FLSA). The decision, applying section 362(b)(4) of the bankruptcy code, rejects a contrary holding by the Sixth Circuit and provides persuasive authority within the Third Circuit that an employer cannot shield itself from FLSA enforcement actions by seeking protection under the bankruptcy code.

Generally speaking, filing for federal bankruptcy protection automatically stays the commencement or continuation of judicial, administrative or other actions or proceedings against a debtor. The bankruptcy code, however, carves out limited exceptions to the reach of the automatic stay, including an exception for certain police and regulatory actions under section 362(b)(4).

Section 362(b)(4) provides that:

> The filing of a petition . . . 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’s . . . police or regulatory power[.]

In *Stewart v. Holland Acquisitions, Inc.*, the DOL filed a civil complaint against Holland Acquisitions, Inc. (Holland) and its principal, alleging willful and repeated failures to pay its employees overtime and maintain adequate employment records both in violation of the FLSA. Holland subsequently filed a chapter 7 bankruptcy and asserted that the bankruptcy filing stayed the FLSA suit.

The court first noted that there was no dispute that the DOL is a “governmental unit” as defined by section 101(27) of the bankruptcy code, which includes departments, agencies, or instrumentalities of the United States. Nor was there any dispute that the DOL is not seeking to enforce a pre-existing money judgment. Instead, the DOL is seeking to enjoin further violations of the FLSA and obtain a monetary judgment in the form of back wages and liquidated damages.

The court explained that that [t]he Third Circuit applies two ‘overlapping’ and ‘complementary’ tests to determine whether a governmental unit’s action advances the unit’s ‘police or regulatory power’ such that the exception to the automatic stay would be triggered.”

(quoting *In re Nortel*, 669 F.3d 128, 139 (3d Cir. 2011)). First, the "pecuniary purpose" test considers whether the action seeks to protect a pecuniary governmental interest in a debtor's property as opposed to protecting the public safety and health. Second, the "public policy" test considers whether the action is in furtherance of public policy rather than adjudicating private rights.

Holland, relying primarily on the Sixth Circuit's decision in *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001), argued that the FLSA action failed the public policy test because the DOL, in seeking a judgment for back pay, was seeking primarily to protect the private rights of Holland's employees. The court rejected that argument, concluding that the Sixth Circuit's reasoning contrasts with principles applied by courts within the Third Circuit and would "substantially impair the core remedial purposes of the FLSA." In sum, the court concluded that the DOL's remedial authority under the FLSA – even when used, in part, to vindicate the personal rights of specific employees – has the overall purpose of advancing the public welfare. Further, the DOL's enforcement authority serves to "bring a culpable employer into compliance with the FLSA" and "serves to deter others from failing to fulfill their wage-payment duties under the FLSA." Thus, despite the fact that a judgment in favor of the DOL would result in an award of backpay for specific individuals, the purpose of such action is to protect the welfare of employees and foster employer compliance with the FLSA. Accordingly, the court held that the DOL could proceed with its action against Holland notwithstanding the automatic stay. The court did note, however, that although the automatic stay would not prevent the court from entering judgment against Holland, enforcement of any such judgment would have to be adjudicated by the bankruptcy court.

For more information, contact Daniel M. Pereira at 215.564.8747 or dpereira@stradley.com.

Takeaway

It is not uncommon for entities facing costly litigation and a potentially significant civil judgment to file for bankruptcy protection in order to afford themselves the benefits of the automatic stay. Among other things, filing a bankruptcy petition provides such debtors an opportunity to hit the pause button on the litigation, create some breathing room, and hopefully limit the damage of any potential judgment. In the absence of any controlling precedent, an employer operating within the Third Circuit and facing down a significant FLSA enforcement action might look to the Sixth Circuit's Chao decision and consider filing for bankruptcy protection in order to stay the litigation. The court's decision in Holland should give room for pause to any employer considering such a strategy. Although not binding precedent, the decision provides persuasive authority within the Third Circuit that the police and regulatory exception under section 362(b)(4) extends to FLSA enforcement actions such that the automatic stay will not protect a wayward employer from the FLSA's reach.

 © 2021 Stradley Ronon Stevens & Young, LLP