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W A G E A N D H O U R

Tip Credit and Pooling Law Challenges Employers

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Special to the Legal

Wage and hour litigation continues to be brought in near-record numbers, with more than 4,300 Fair Labor Standards Act (FLSA) cases filed in federal court during the first half of 2016. A review of those filings, as well as several recent decisions, illustrates that the hospitality industry remains a mainstay in wage-and-hour cases.

In particular, recent litigation against restaurants has challenged application of the tip credit to servers who are performing nontipped duties. While the minimum wage under federal law is \$7.25 per hour, the FLSA, and many state laws, permit employers to pay tipped employees less than that minimum wage where they take a “tip credit” (currently employers can pay employees subject to the tip credit \$2.13 per hour under the FLSA and 40 percent of the statutory minimum wage under the Pennsylvania Minimum Wage Act). The tip credit allows employers to rely on the tips of patrons to make up for the remainder of the minimum wage amount, even though the tipped amount is not paid directly by employers to their tipped employees.



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BREAKING DOWN THE TIP CREDIT

There are several requirements employers must meet in order to take the tip credit. Under the FLSA, a “tipped employee” is one who “customarily and regularly receives more than \$30 a month in tips,” with service charges not qualifying as tips. Employers must inform employees of the following in advance of using the tip credit:

- The amount of cash wage the employer is paying a tipped employee, which under the FLSA currently must be at least \$2.13 per hour;
- The amount claimed by the employer as a tip credit, which cannot exceed the difference between the cash wage paid and the minimum wage or the amount of tips actually received by the employee; and

- That all tips received by the tipped employee must be actually retained by the tipped employee (except for a valid tip pooling arrangement, which can only include other employees who customarily and regularly receive tips).

Importantly, employers must demonstrate that employees actually received the amount credited in tips, and if employees did not receive that amount, employers must make up the difference so that employees are actually paid at least the minimum wage.

The U.S. Department of Labor (DOL) regulations provide that employers cannot take the tip credit if employees are performing nontipped work. The “dual jobs” regulation provides that where an employee works in two different jobs for the employer, for example as a waiter and as a “maintenance man,” he only qualifies as a tipped employee (and can be eligible for the tip credit) for his waiter duties. The DOL distinguishes this from what it refers to as “related duties,” of a waitress like “cleaning and setting tables, toasting bread, making coffee and occasionally washing dishes or glasses.” These related duties do not need to be “directed toward producing tips.”

In its Field Operations Handbook, which the DOL refers to as its operations manual, the DOL has stated that

“where the facts indicate that specific employees are routinely assigned to maintenance, or that tipped employees spend a substantial amount of time (in excess of 20 percent) performing general preparation work or maintenance, no tip credit may be taken for the time spent in such duties.”

THE TIP CREDIT AND THE FIELD OPERATIONS HANDBOOK

Over the last several years the level of deference that courts accord DOL regulations and guidance has been hotly contested, with the U.S. Supreme Court most recently adding more fuel to the fire in *Encino Motorcars v. Navarro*, No. 15-415 (2016). Finding that the U.S. Court of Appeals for the Ninth Circuit improperly deferred to a DOL regulation where the DOL “gave almost no reasons at all” for its change in position, the Supreme Court remanded the case to the Court of Appeals “to interpret the statute in the first instance.”

With respect to the Field Operations Handbook’s 20-percent requirement, courts are split as to whether this interpretation should be accorded deference.

The Eighth Circuit in *Fast v. Applebee’s International, Inc.* Nos. 10-1725, 10-1726 (638 F.3d 872 (2011)), deferred to the DOL’s Field Operations Handbook, finding that the 20-percent limitation was an interpretation of the DOL’s ambiguous regulation. Recently in *McLamb v. High 5 Hospitality*, Case No. 16-00039, the U.S. District Court of Delaware followed *Fast*, refusing to dismiss the plaintiff’s FLSA claim that she was not properly paid the minimum wage for her “dual job” or for her “related duties” that exceeded 20 percent of her time as a bartender. Just days later, on July 15, 2016, the Seventh Circuit also looked at this issue in *Schaefer v. Walker Bros. Enterprises, Inc.*,

No. 15-1058 (2016). While both parties in *Schaefer* agreed that the DOL’s Field Operations Handbook was entitled to deference, the Seventh Circuit evaluated whether wiping down burners and woodwork and dusting picture frames was “related” to servers’ duties. Relying on the Supreme Court’s statement in *Sandifer v. United States*, 12-417 (2014), that the FLSA does not “convert federal judges into time-study professionals,” the Seventh Circuit reasoned that the word related should be interpreted flexibly. This led the Seventh Circuit to conclude that “the possibility that a few minutes a day were devoted

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to keeping the restaurant tidy does not require the restaurants to pay the normal minimum wage rather than the tip-credit rate for those minutes.”

Creating a split of authority, the U.S. District Court of Arizona in *Marsh v. J. Alexander’s*, 2:14-cv-01038, dismissed a tip credit case and refused to defer to the DOL’s Field Operations Handbook, finding that the DOL’s regulation was not ambiguous. This case currently is on appeal before the Ninth Circuit and the recently DOL submitted an amicus brief urging reversal of the District of Arizona decision.

TIP POOLING

Employers also continue to face litigation regarding their tip pooling

practices. Cases challenging tip pooling arrangements typically allege that employees who are not eligible for the tip credit are impermissibly being included in tip pools, and as a result their participation reduces the amount of tips received by each individual employee in the pool. The DOL Field Operations handbook specifically lists wait staff, bellhops, counter personnel, bussers, and service bartenders as employees who “customarily and regularly receive tips,” while it excludes “back of the house” staff such as janitors, dishwashers, chefs and laundry room attendants.

Some examples of recent settlements in tip pooling cases include a \$1.3 million settlement in December 2015 by a Red Robin franchisee, where the plaintiffs alleged that the restaurant impermissibly included cooks and kitchen workers in the tip pool. New York restaurant Le Cirque paid \$1.1 million to settle a wage-and-hour case in September 2015 that included allegations of improper tip pooling. The DOL also has been active on this front, filing a lawsuit in the Southern District of Ohio challenging the tip-pooling practices of three Mexican restaurants. That case was resolved by way of consent judgment in March 2016 for \$190,000, which was distributed to 67 employees.

NEXT STEPS

Given the continued litigation challenging tip pooling arrangements as well as the recent developments in the tip credit arena, employers utilizing the tip credit or tip pooling should assess current practices and consider modifications to those practices to address this ongoing area of legal exposure. •