Federal Appeals Court Refuses To Reinstate Tip-Pooling Policies

LABOR REGULATION BANNING SUCH POLICIES UPHELD BY 9TH CIRCUIT COURT

Insights
9.07.16

Restaurants and other hospitality businesses in the Western U.S. received bad news late yesterday as a federal appeals court refused to strike down a controversial tip-pooling regulation. The U.S. Department of Labor's (USDOL) rule prohibits businesses from requiring employees to share their tips even if the tipped employees are paid minimum wage, and although a group of hospitality employers hoped that a court would reject the rule as running contrary to well-established law, the 9th Circuit Court of Appeals once again upheld the rule.

Yesterday's order was not without controversy, however, as 10 circuit court judges took the unusual step of dissenting from the court's decision not to take the case up on a full panel ("en banc") appeal. The blistering dissent could portend a Supreme Court review of the decision, but unless and until that happens, all hospitality businesses operating in the 9th Circuit – which includes the states of California, Nevada, Washington, Arizona, Oregon, Idaho, Montana, Hawaii, and Alaska – must continue to follow the rule (*Oregon Rest. & Lodging Association v. Perez*).

Background: 9th Circuit Reversed Its Own Prior Decision
In 2011, the USDOL promulgated a contentious tip-pooling regulation in direct response to the 9th Circuit's 2010 decision in *Cumbie v. Woodie Woo, Inc*. In that case, the 9th Circuit Court considered whether section 203(m) of the Fair Labor Standards Act (FLSA) prohibits all employers from allowing non-customarily tipped employees (i.e. kitchen staff) from sharing in the company's tip pool, even when the front house staff does not take a tip credit.

The 9th Circuit noted the FLSA's silence as to whether a non-tip-credit restaurants could prohibit other employees from participating in the tip pool, and reasoned that the FLSA permits the tip-pooling arrangements because none of the employees were using the tip pool as a credit against minimum wage. Dissatisfied with the court's decision, the USDOL issued a new regulation, stating that tips are the "sole property" of the tipped employee and cannot be used in a pool to share with back house staff.

A group of concerned hospitality employers challenged this rule in the case of *Oregon Restaurant and Lodging Association v. Perez*, but the 9th Circuit upheld the Department's rule in a surprising 2-1 decision on February 23, 2016. By issuing this decision, the court reversed itself and rejected its

earlier holding in the *Cumbie* case, explaining that the USDOL's interpretation of section 203(m) was "reasonable" and therefore entitled to deference from the courts (read more here).

The decision triggered immediate concern, and the group of employers asked a full panel of 9th Circuit judges to revisit the decision in hopes that it would be overturned. Yesterday, the full slate of 9th Circuit judges voted to refuse a rehearing, which immediately drew contentious reactions and stirred deeper questions about the breadth of the USDOL's power to create new law.

"A Constitutional And Administrative Law Misstep"

Most importantly, the court's denial of en banc review elicited a vigorous (and rare) dissent from Judge Diarmuid O'Scannlain, who condemned the decision as flouting not only constitutional principles, but even "the most elemental teachings of administrative law." Joined by nine other 9th Circuit judges, O'Scannlain wrote that Congress' silence as to whether the FLSA bans tip-pooling under these circumstances does not provide the USDOL with carte blanche authority to create new law. His dissent sardonically asks, for example, if the FLSA is similarly "silent" as to whether he can require his law clerks to wear business attire in his chambers, does that mean the USDOL is therefore free to prohibit this too?

The 20-page dissent dismisses the majority's argument that court deference to the USDOL regulation was warranted in this case.

Circuit Split May Lead To SCOTUS Review

"The only court in the land to misread *Cumbie* is our own!" writes Judge O'Scannlain in the dissent. "It should come as no surprise that our sister circuits have roundly and forcefully repudiated the specious theory of agency power our court now adopts." The dissent points out that the 4th Circuit has already expressly agreed with the *Cumbie* decision in a 2015 decision, reasoning that the section 203(m) does not provide for a free-standing requirement pertaining to all tipped employees, but applies only to those taking a tip credit.

The dissent then points out that lower federal courts in Georgia, Utah, and Maryland have all already invalidated the USDOL regulation as well; a New York federal court has strongly criticized it, and the 9th Circuit stands alone in its decision upholding the rule.

The unapologetic and highly critical dissent could serve as a tempting invitation for the U.S. Supreme Court (SCOTUS) to accept review of the matter, especially as it points out that "the majority ignores binding Supreme Court and circuit precedent and allows the Department of Labor to defy the clear and unambiguous limits." Hospitality employers can only hope that the SCOTUS will soon have an opportunity to decide if they want to save the 9th Circuit from, as Judge O'Scannlain puts it, "having stumbled off a constitutional precipice."

Possible Solutions For Hospitality Employers

Unless the ruling is overturned by the Supreme Court, many restaurants and hospitality businesses in the Western U.S. will have to reconfigure how they disperse tips. If that is the case, restaurants

in the Western U.S. will have to reconfigure how they disperse tips. If that is the case, restaurants using a tip pool will need to ensure that none of their back-of-the-house staff – line cooks, dishwashers, expeditors, or any other staff that may not fall within the FLSA's definition of "customarily and regularly tipped employees"— partake in sharing the tip pool.

Of course, for many restaurants, excluding a large portion of staff from the opportunity to earn tips could be disastrous for morale, and restaurant owners are considering their alternatives. For example, some restaurants include separate tip lines for front-of-the-house and back-of-the-house staff. Others have abandoned the tipping system altogether and are instead charging customers a mandatory service fee.

Given the uncertainty of success in challenging the USDOL's new rule, restaurants and other hospitality businesses in the Western U.S. should consider implementing these changes as soon as possible.

If you have questions about this ruling or how it may affect your business, please contact your Fisher Phillips attorney.

This Legal Alert provides an overview of a specific 9th Circuit Court order. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

Service Focus

Wage and Hour

Industry Focus

Hospitality