



# Recent Ruling Means You May Need To Revise Your Tip-Pooling Plan

Insights

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In a recent decision by the federal 9th Circuit Court of Appeals, a 2011 U.S. Department of Labor (USDOL) regulation that significantly restricts the common practice of “tip pooling” among wait staff and other service employees was revived. As a result, you should now review your tip-pooling practices and procedures to ensure compliance with the regulation, even if you already comply with California state tip-pooling rules.

## Tip Credits Not Permitted In California

Tips have traditionally been regarded as the property of the tipped employee. As a result, and to prevent employers from using tips as a substitute for hourly wages, regulators have historically restricted what employers may do with tip proceeds. For example, California and some other states prohibit any deductions being taken from tips.

However, in some states (though not in California), under the federal Fair Labor Standards Act (FLSA), “tip credits” are permitted where the employer can pay an hourly rate that is below minimum wage provided that tips received by the employee make up the difference and bring the hourly rate up to the legal level.

## Tip Pooling Permitted in California, With Limitations

Tip pooling is a practice where tips are redistributed among employees, such as bussers and hosts in a restaurant. Many regulators have restricted tip-pooling practices. For example, California’s Division of Labor Standards Enforcement has stated that tip pooling must be “fair and reasonable” and should be limited to employees who provide “direct table service” or who are in the “chain of service” provided to the tipping customer.

Also, the FLSA limits participation in tip pools to employees who “customarily and regularly receive tips.” However, under prior interpretations by the USDOL and courts, this restriction only applied to employers who use “tip credits” against minimum wage. Because California already prohibits tip credits, many employers here have assumed that they need not be concerned with the FLSA’s tip-pooling restrictions. This assumption may change with this new 9th Circuit case.

## The DOL’s Amended 2011 Regulation And The *Oregon Restaurant Decision*

By way of background, the 9th Circuit confirmed, in a 2010 case called *Cumbie v. Woody Woo*, that the

practice of pooling tips with non-traditionally-tipped employees was permitted where tip credits are not taken. This is because the court noted that the FLSA and the accompanying USDOL regulations were silent as to who may participate in a tip pool if the employer does not take a tip credit.

In 2011, the USDOL responded by issuing an amended regulation generally prohibiting tip pooling with non-traditionally-tipped employees, including employers who do not take “tip credits.” This significant change in the regulation sparked controversy, and several restaurant and lodging associations sued the USDOL in federal court arguing that the agency had exceeded its authority by overturning prior court precedent.

The lower trial court ruled that the amended regulation was invalid because it was inconsistent with earlier decisions of the 9th Circuit. On appeal, however, the 9th Circuit disagreed. In a decision issued on February 23, 2016, the appeals court ruled that its prior decision in the *Cumbe* case had only highlighted the absence of an express prohibition on pooling tips with non-traditionally-tipped employees where no tip credit is taken.

Because the amended regulation now expressly prohibits all tip pooling except with employees who “customarily and regularly receive tips,” the court said that the new regulation should be upheld because it is not contrary to, nor an unreasonable interpretation of, the FLSA. As a result, employers in the 9th Circuit will be prohibited from pooling tips with employees who do not “customarily and regularly receive tips,” regardless of whether tip credits are taken against minimum wage.

### **California Law Restricting Tip Pooling Remains In Place**

Employers in California and many other states in the 9th Circuit are already familiar with significant restrictions on tip pooling. For example, California state law prohibits tip credits, and generally prohibits managers and supervisors from sharing in tips paid to rank-and-file staff. The *Oregon Restaurant* decision does not alter such state laws.

### **Potential Further Review By 9th Circuit**

One of the employer associations that brought the *Oregon Restaurant* lawsuit has announced that it will seek a review before an 11-judge panel of the 9th Circuit (known as “*en banc*” review). Until the full panel decides whether to uphold or overturn the decision, the existing law remains in place. However, it could be quite some time before the 9th Circuit acts on the petition for review, and the outcome is far from certain.

### **Next Steps For Employers With Tipped Employees**

In light of this decision, you should review tip-pooling policies and practices for compliance with the amended FLSA regulation and California law. Also, because California law has evolved separately from the FLSA and USDOL regulations, you should also consider steps to comply with the FLSA.

Of course, any resulting changes to comply with the law could impact your employees, and may cause morale and retention issues. To avoid morale issues and other problems, you may want to consider alternatives such as mandatory service charges.

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