Here's a Tip: Tread Carefully (Updated 04 09 18)

Insights
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UPDATED 04 09 18: As was anticipated, the US Department of Labor (USDOL) announced in a Field Assistance Bulletin its intent to proceed with rulemaking in the "near future" to address the impact of the amendments to the Fair Labor Standards Act made in the Consolidated Appropriations Act passed last month. In the meantime, USDOL provided that, aside from tip-credit scenarios, the FLSA does not prohibit employers "from allowing employees who are not customarily and regularly tipped – such as cooks and dishwashers – to participate in tip pools." With respect to the portion of the amendment to the FLSA which provided that managers and supervisors cannot "keep" the tips, as an enforcement policy the agency will rely upon the duties test for the executive exemption in determining who is a manager or supervisor for purposes of section 3(m). We anticipate that USDOL will release proposed rulemaking within the next several months.

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As we previously wrote, Congress has now amended Section 3(m) of the federal Fair Labor Standards Act (FLSA) to prohibit an employer from "keep[ing] tips received by its employees for any purpose, including allowing managers or supervisors to keep any portion of employees' tips, regardless of whether or not the employer takes a tip credit." So why did Congress include this amendment within a budget reconciliation bill, with little fanfare and apparently no public debate? With that question in mind, we look back at the series of events that culminated in the recent amendment. We also highlight questions resulting from the amendment that will likely require future agency guidance and/or regulatory action.

Woody who?

In the 2010 *Cumbie v. Woody Woo, Inc. et al* case, the 9th Circuit Court of Appeals (which hears cases out of California, Washington, Nevada, Oregon, Arizona, Montana, Alaska, Hawaii, and Idaho) considered whether an employer, who did *not* take the Section 3(m) tip credit, could require servers to contribute to a mandatory tip pool which involved "kitchen staff," i.e., employees who are not customarily tipped in the restaurant industry. The 9th Circuit concluded that nothing in the FLSA prohibited this tip pooling practice. The court specifically ruled that the FLSA did not restrict employee tip-pooling arrangements when no tip credit is taken.

Unhappy with this decision, the United States Department of Labor (USDOL) responded by issuing a new regulation in 2011 that declared that "tips are the property of the employee *whether or not the* new regulation in 2011 that declared that "tips are the property of the employee *whether or not the employer has taken a tip credit*." 29 CFR 531.52 (emphasis added). The obvious goal of the regulation was to prohibit tip-pooling arrangements that included employees who are not customarily tipped (e.g., back of house kitchen-staff, among others). This regulation was controversial from the start, and became the subject of numerous lawsuits.

In 2016, the same court (9th Circuit) which six years earlier had approved of a tip pool involving non-tipped employees so long as the employer paid the full minimum wage and did not take the tip credit, held that the 2011 regulation was valid and entitled to deference. Other courts, however, reached different conclusions. For example, as we previously noted, the 10th Circuit Court of Appeals held in a 2017 opinion that USDOL had no authority to issue the 2011 regulation because the FLSA provided the agency with no authority to regulate an employer's tip practices when the tip credit was not taken.

USDOL attempts to right its 2011 error

In December 2017, recognizing that the 2011 regulation lacked a statutory basis, USDOL published a proposal to revise the regulation by explicitly permitting mandatory tip pooling arrangements that include non-customarily tipped employees, provided that the employer does not take the tip credit. In announcing this proposed rule, USDOL acknowledged its "serious concerns that it incorrectly construed" the FLSA when promulgating the 2011 regulation. In its proposal, USDOL acknowledged that future guidance might be appropriate as to the issue of whether employers not relying on the FLSA tip credit could keep any portion of an employee's tips.

However, the political winds began to whip almost immediately after the close of the period for public comment on the proposal when it emerged that USDOL did not include certain economic data along with its proposal. Critics contended that the data showed that employees would be "cheated out of billions" if employers were permitted to keep all or some of an employee's tips – i.e., the issue which USDOL raised but did not want to take on in its 2017 proposed rule. They described this practice as "tip skimming" and argued that the proposed rule should be withdrawn due to the omission of the economic data. Setting politics aside, however, this criticism ignored the fact that USDOL was righting its 2011-wrong because, as UDOL acknowledged (and as we wrote here), there simply was no basis in the FLSA at that time to regulate an employer's control of tips when no tip credit was taken. Whatever the "missing" economic data might show was irrelevant to that statutory reality.

Then, in a surprising move, Congress stepped into the fray last week. As noted above, following the amendment to Section 3(m), an employer may not keep tips for itself for any purpose, regardless of whether it takes the tip credit. Congress also explicitly stated that USDOL's 2011 regulation "shall have no further force or effect" to the extent that portions do not address Section 3(m) as it existed *at the time*. Perhaps even more surprising, the statutory revisions included significant penalties, particularly for an employer that runs afoul and *is* taking the tip credit.

End of the story? Not exactly....

While Congress has now answered the noisiest part of the FLSA/tip debate – "can an employer keep the tips of an employee under any circumstances? No." – outstanding questions still remain. Will USDOL move forward and issue a final rule which *explicitly* acknowledges the validity of mandatory tip pooling arrangements that involve non-customarily tipped employees if no tip credit is taken? Will USDOL address that question through another means, perhaps by an Administrator's Opinion or through the internal Field Operations Handbook (FOH)? Or, will USDOL simply view that issue as settled by Congress striking down parts of the 2011 regulation that started the problem in the first place and by singling out employers, managers, and supervisors (as opposed to all employees), as being unable to retain any portion of an employee's tips.

That is not all. Again, Congress has now said that "managers" and "supervisors" may not keep any portion of an employee's tips. But those terms are not defined in the FLSA. Will USDOL issue guidance about which employees fit within those terms?

The Bottom Line

While it may be tempting to view the recent Congressional amendment as the end of the story, the final chapter has not yet been written. For now, employers *not* relying on the tip credit should work with legal counsel to determine whether practices that had been lawful, despite the confusion created in 2011, might violate the statutory language. Additionally, an employer relying on the federal tip credit would be well advised to ensure that its practices do not violate the new language that, while not significantly different from the restrictions already imposed on such an employer, would trigger heightened penalties.

Though employers might appreciate Congress' action in taking on this issue and its decision to only narrowly restrict an employer's ability to redistribute tips in non-tip credit scenarios, the change is nonetheless *more* restrictive, murky in some respects, and more costly thanks to new stiff damages. Thus, for some employers, this move might actually be a loss in the long run.

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