Why Are Courts Deferring to USDOL's "20% Rule" Restricting the FLSA's Tip Credit?

Insights
9.28.18

In a case that refuses to go away, the Ninth Circuit, now sitting *en banc*, has held that the plaintiff in *Marsh v. J. Alexander's* stated an FLSA minimum wage claim based on the USDOL's so-called "20% Rule" limiting a tipped employee's activities.

The Ninth Circuit opinion regarding tipped employees illustrates the tangled web we weave when de-facto legislation takes place outside of Congress. In a nutshell, the federal court of appeals has followed the Eighth Circuit and given deference to a sub-regulatory agency position that substantially restricts a tipped employee's activities, concluding that the restriction is supported and reasonable. We have previously highlighted the flaws in such reasoning, so we will address here only one of the troubling aspects present throughout the opinion.

Employers Presumed To Be On Notice – A Fairy Tale
Imagine, if you will, going through the steps of evaluating the application of the tip credit to an employee. You work for an FLSA-covered employer with multiple restaurants in a state with no wage-hour law of its own. A recent hire from another state thinks you are misapplying the tip credit. You glance over the tip notice and USDOL-issued poster used at the employee's location. Everything appears correct and current.

Where do you look next?

It appears that the court's answer is, the "internet." Yes, the Ninth Circuit concluded that USDOL provided notice of the "20% Rule" simply because its position was available online. (Never mind that there is no affirmative obligation under the FLSA to consult various agency guidance: Field Operations Handbook, opinion letters, amicus briefs, or otherwise.) But you know better than to believe everything that you read online, let alone find through random searches, and even the USDOL's website is chockfull of sub-regulatory materials. So, being savvy, you start with the FLSA law as set forth in the statutes.

Reading the tip credit provision and, more importantly here, the definition of a "tipped employee", you logically think that Congress decided to provide this credit (among others) for an employee who could consistently depend on tip income at a level it then deemed sufficient. The employee at issue was hired as a server and receives *direct* tips of more than $30 *every* month. There are no tip pooling/sharing arrangements whatsoever. It is difficult to envision a circumstance that one would need to further delve into what constitutes "occupation" or "customarily and regularly" to apply the statutory language to these facts, let alone now that the U.S. Supreme Court has opined that *all* parts of the law should be given a fair reading.

Just why does the court believe employers would find it necessary to look further?

Nonetheless, you are curious why the server believes there is a problem, so you go to the regulations to see if you are missing something in your reading of the "tipped employee" definition. You find the dual jobs language. Now, the statutory language provides for the application of the tip credit to "tipped employees". The regulation title itself invokes notions of someone picking up a second job or at least an occasional shift in another capacity. Reviewing the examples you conclude that the regulation provides a narrow carve out from the definition for such situations. In any event, the server complaining is employed in one capacity, albeit one with a variety of duties, that would indicate that there are no "dual jobs".

Again, why does the court believe an employer would think it must look further?

You have conducted a rational, methodical analysis and believe the tip practices are in compliance. Perhaps if the employee continues to push, you contact an attorney or decide to throw caution to the wind and "Google" it. You might come across the 20% Rule and scratch your head wondering (1) how anything "in excess of 20 percent" constitutes a *substantial* amount of time and (2) what to do about a seemingly random source appearing to contradict the language in the statute and regulation.

But what if someone, somehow hit 21% and the tip credit was applied?

As incredulous as it might sound, if you still applied the tip credit to that time, apparently the Ninth Circuit would conclude that you violated the FLSA based on non-compliance with the 20% Rule despite the provision being set forth in this manner or even whether you had become aware of it at all.

Deference Used As A Sword Instead of A Shield – A Real-Life Nightmare

There are times when court deference to an agency is used as a shield and supports a finding of no violation. But it is another thing entirely when it comes to enforcing provisions against employers that are not promulgated as *regulations*. An *agency* should not be able to sidestep its responsibilities and an *employer* be held accountable for it. This problem already exists with respect to agency *interpretations* published in the *Code of Federal Regulations* (*see* 29 C.F.R. §§ 775.0 - 794.144) , and rationales like those discussed in *Marsh* just extends that problem to other, less formal guidance.

While one can appreciate the efforts USDOL is making with regards to education and compliance, the courts expect too much if, as it seems, they mean that employers are *obligated* to find and apply guidance simply because it exists. This seems contrary to the concept of "guidance". Even to the extent the concurring and dissenting judges agree as to there being notice of the agency's position, they do not agree as to when/how this occurred. That dispute alone demonstrates that, regardless of the form, sub-regulatory positions such as the so-called 20% Rule should not be used as a sword (even assuming they are consistent with the statute, consistent with the regulation, and within the scope of the agency's authority on the *particular* matter; though this is *not* the case here).

If an agency is so certain of a position that an employer violating it has acted unlawfully, should it not promulgate regulations to that effect?

The Bottom Line
Employers should be aware that plaintiffs' attorneys are continuing to pursue these claims, even though such claims are not supported by a plain-reading of the statutory language or the regulation. Whether or how an employer can minimize these risks is a very fact-specific analysis. In the Ninth Circuit (which includes the states of Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington) and the Eighth Circuit (Arkansas, Iowa, Missouri, Minnesota, Nebraska, North Dakota, South Dakota), signs point to micro-managing employees on a level that is difficult to imagine. It certainly does not promote a team-oriented workplace and is burdensome on both *employers and employees*. Suggesting that the "simple" solution is for employers to invest in a sophisticated timekeeping system that can code different rates for different activities underscores the court's lack of understanding the problem with attempting to distinguish between activities, in real time, in a fast-paced environment.

So what "simple" solutions exist? Until the USDOL provides some relief with new regulations clarifying the narrowness of any "dual jobs" limitation on the tip credit, the only guaranteed solution is to not do any of these things and forgo the tip credit. Understandably, at that point an employer might decide to simplify FLSA compliance even further and prohibit tips altogether, an outcome that employees presumably would find far less desirable.

Related People

Caroline J. Brown
Of Counsel
404.240.4281
Email