# 9th Circuit "Tips" Against Tip-Pooling Policies

Insights
3.01.16

In a surprising decision that may require many restaurants and other hospitality businesses in the Western U.S. to alter their labor practices, the 9th Circuit Court of Appeals upheld a 2011 U.S. Department of Labor (USDOL) rule that prohibits businesses from requiring employees to share their tips even if the tipped employees are paid minimum wage. The February 23, 2016 decision applies to all businesses operating in the 9th Circuit, which includes the states of California, Nevada, Washington, Arizona, Oregon, Idaho, Montana, Hawaii, and Alaska (*Oregon Rest. & Lodging Association v. Perez*).

**Background Into Tip Credits And Tip-Pooling**
Under the federal Fair Labor Standards Act (FLSA), employers are permitted to utilize a limited amount of employees' tips as a credit against their minimum wage obligations through a tip credit. Under current federal law, if an employee earns $5.12 an hour in tips, it would be permissible for a restaurant to only pay the employee $2.13 an hour in cash wages in order to meet the $7.25 federal minimum wage.

In most Western states, however, employers are not permitted to take tip credit (including California, Nevada, Washington, Oregon, Montana, and Alaska) pursuant to state law. Restaurants in these states are required to pay employees cash wages at minimum wage levels regardless of the tips they receive.

Some employers in these (and other) states have instituted tip-pooling programs. Under such plans, restaurants require servers to share the tips they receive with workers in customarily non-tipped positions, such as back-of-the-house staff (cooks, dishwashers, etc.).

**Court Pronounces Tip-Pooling OK; USDOL Changes Rule**
The most recent legal pronouncement from the 9th Circuit about the practice of tip-pooling came in the 2010 case of *Cumbie v. Woody Woo Inc.* In that case, the appellate court rejected a waitresses' lawsuit against a restaurant claiming that the restaurant's mandatory tip pool violated the FLSA. There the court reasoned that the FLSA permits tip-pooling arrangements so long as the employer does not take tip credits against employees' wages.

The court concluded that the FLSA is silent as to who may participate in a tip pool if the employer does not take a tip credit, which meant that there appeared to be no legal restriction on the ability of restaurants to institute mandatory tip pools benefitting back-of-the-house employees in such cases.

In direct response to *Woody Woo*, the USDOL instituted a new regulation in 2011 stating that tips are the sole property of the tipped employee and cannot be used in a pool to share with back-of-the-house employees. The USDOL's position was that an employer cannot use an employee's tips except where possible to do so as a credit against minimum wage (an arrangement unavailable to employers in many Western states). In February 2012, the USDOL issued a directive to its field agents to begin enforcement of its new regulation.

**Battle Lines Drawn Over New Regulation**

In reaction to this new position, a group of restaurant and lodging associations from Washington, Oregon, and Alaska sued the USDOL in July 2012. The group argued that the USDOL had exceeded its statutory authority by issuing that rule, and that the agency ignored the binding precedent established by the *Woody Woo* case.

Around the same time, two casino dealers working for Wynn Las Vegas brought a wage and hour lawsuit against the casino. The employer required dealers and other tipped employees to participate in a tip-pooling plan, and the dealers claimed the casino was unlawfully taking their tips to share with other workers.

In 2013, a federal judge in Portland handed a victory to the group of associations and invalidated the USDOL's new tip-pooling regulations, and shortly thereafter a federal judge in Las Vegas ruled in favor of the casino and dismissed the dealers' case. The USDOL appealed the Oregon decision, and the 9th Circuit consolidated the companion case against Wynn into one appeal.

**Shock Decision Throws Tip-Pooling Plans Into Doubt**

In a surprise 2 to 1 ruling, the 9th Circuit upheld the USDOL's 2011 rule, holding that the regulation was reasonable. The court also said that the rule was consistent with Congress' goal under the FLSA of ensuring that tips stayed with the employees who received them.

Of course, many are confused by this conclusion. Judge N. Randy Smith, the lone vote against the USDOL rule, puts it best: "Colleagues," he begins in an exasperated dissenting opinion, "even if you don't like circuit precedent, you must follow it." As he points out, this same court decided in the 2010 *Woody Woo* case that the FLSA's bar against tip-pooling among the back-of-the-house staff applies only in tip-credit states. There are no tip-pool restrictions in those states where customarily tipped employees earn minimum wage.

Nevertheless, despite the confusion and exasperation, the *Oregon Rest. & Lodging Association v. Perez* decision reverses this precedent, and could soon be controlling law in the 9th Circuit.

**Possible Solutions For Hospitality Employers**

The group of restaurant associations has announced that it will seek a review of this decision before an 11-judge panel of the 9th Circuit (known as *en banc* review). Until it is determined whether that review will be granted, employers can continue to operate tip-pooling plans so long as they

recognize that this decision may go into effect at any time. In other words, continuing with the status quo may prove risky.

Unless the ruling is overturned by an *en banc* panel or the U.S. 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 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 decision. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.*

## *Service Focus*

Wage and Hour