Legal Update Article

FLSA Amendment Bars Employers from Retaining Tips But Removes DOL Prohibition on Tip Sharing

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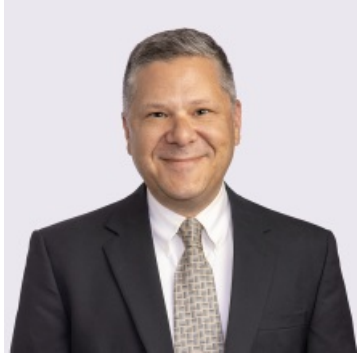

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An amendment to the Fair Labor Standards Act (FLSA) in the omnibus budget bill, "Consolidated Appropriations Act, 2018," passed by Congress and signed by President Donald Trump on March 23, 2018, provides that an employer "may not keep tips received by its employees for any purposes, including allowing managers or supervisors to keep any portion of employees' tips, regardless of whether or not the employer takes a tip credit."

However, the amendment also expressly rescinds the portions of Department of Labor (DOL) regulations that prohibited employers from requiring tipped employees (*e.g.,* servers) to share their tips with traditionally "non-tipped" employees (*e.g.,* cooks). That prohibition is no longer valid, thus restoring federal law as it existed prior to the 2011 regulation, *i.e.,* permitting, under federal law, tipped and non-tipped workers to share tips, as long as the employer does not take a "tip credit."

Tip Pooling: A Brief History of Jurisprudence under FLSA

The tip credit under the FLSA permits an employer to pay its tipped employees less than the federal minimum wage of $7.25 per hour, and a minimum of $2.13 per hour, relying on customer tips to satisfy the difference between the hourly wage and the minimum wage.

In *Cumbie v. Woody Woo, Inc.,* 596 F.3d 577 (9th Cir. 2010), the U.S. Court of Appeals for the Ninth Circuit held that if an employer uses the tip credit, the only employees who can participate in a tip pool or share are those who customarily and regularly receive tips, that is, "front of the house" employees such as servers, bussers, runners, and bartenders. Conversely, the Ninth Circuit held, if the employer does *not* use a tip credit, no such restriction applies.

Thus, under federal law as interpreted in *Cumbie,* employers who did not utilize a tip credit could allow both tipped and non-tipped workers to share in the tips received. This practice mainly affected employers in states that do not permit the use of tip credits because employers in those states necessarily did not take a tip credit under federal law.

The Obama Administration did not like this ruling and, in 2011, did something about it. That year the DOL, expressly noting its disagreement with *Cumbie,* issued a final rule stating that tips are the property of the employee and can be pooled only among customarily tipped employees *even if* the employer has paid its employees at or above the minimum wage and has not taken a tip credit. 29 C.F.R. § 531.52 (2011).

Employers, however, did not like the new rule and, likewise, did something about it. The Oregon Restaurant and Lodging Association brought suit against the DOL, challenging the validity of the 2011 rule in light of *Cumbie.* A similar challenge to the rule was raised in a Nevada lawsuit by casino dealers who alleged their employer violated the FLSA by requiring them to share tips with casino floor supervisors. In both cases, the plaintiff-

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employees were paid at or above the minimum wage and the issue was whether they could be compelled to share their tips with non-tipped employees (as allowed under *Cumbie)* or whether such practice was prohibited (as set forth in the DOL's new 2011 rule). The district courts in both cases deemed the 2011 rule invalid, concluding that, in light of *Cumbie,* restrictions on tip pooling apply only when a tip credit is taken.

In a split decision on appeal, the Ninth Circuit overturned *Cumbie,* holding the DOL had the authority to regulate tip pooling and its 2011 rule was owed deference under the standard set forth in *Chevron U.S.A., Inc. v. NRDC,* 467 U.S. 837 (1984). *Oregon Restaurant & Lodging Assn. v. Perez,* 816 F.3d 1080 (9th Cir. 2016). The dissent in *Oregon Restaurant* criticized the DOL for attempting to circumvent *Cumbie,* stating, "[N]ow, after losing in *Cumbie,* the DOL has decided to go through the backdoor by promulgating a new rule codifying its argument in *Cumbie* and its preferred interpretation of section 203(m)."

Although a petition for rehearing *en banc* was denied, 10 judges on the Ninth Circuit dissented from the denial, signaling a deep circuit split. *Oregon Restaurant & Lodging Assn. v. Perez,* 843 F.3d 355 (9th Cir. 2016) *(reh'g and reh'g en banc denied).* The dissent's description of the circuit split left little doubt this issue would be headed to the Supreme Court: "'Circuit split' does not fully describe the resulting state of affairs. It is more like we have spun out of the known legal universe and are now orbiting alone in some cold, dark corner of a far-off galaxy, where no one can hear the scream 'separation of powers.'" Not surprisingly, the defendant-restaurant association petitioned the Supreme Court for a writ of *certiorari,* which is pending. Meanwhile, the tip-pooling issue arose before the U.S. Court of Appeals for the Tenth Circuit. Rejecting the Ninth Circuit's approval of the 2011 rule, the Tenth Circuit adopted the view expressed in *Cumbie* that restrictions on employers' use of tips apply only when a tip credit is taken, and held that the 2011 Rule to the contrary was invalid. *Marlow v. New Food Guy, Inc.,* 861 F.3d 1157 (10th Cir. 2017).

Trump Administration's Proposed Rule Change

Inheriting these competing views, and facing a potential Supreme Court showdown, the Trump Administration DOL reversed course. Siding with the Tenth Circuit and the dissent in *Oregon Restaurant,* the DOL in late-2017 issued a Notice of Proposed Rulemaking to rescind the tip-sharing prohibitions of the 2011 rule. However, nothing in the language of the proposed new rule would have prevented members of management, or even employers themselves, from retaining employee tips; the proposed rule did not in any way regulate tip distribution where no tip credit was sought and taken. As a result, employee advocacy groups and members of Congress balked. The DOL's new proposal received even further backlash when accusations arose that the agency intentionally secreted a pre-proposal study showing this rule could result in employee tips being retained by employers.

New Congressional Amendment

The amendment to the FLSA unequivocally states that employers may *not* "retain" employee tips regardless of whether a tip credit is taken. The amendment extends this concept to prohibit "managers" and "supervisors" from retaining tips, although it fails to define those terms and, therefore, creates ambiguity as to whether employees with *any* supervisory authority would be prohibited from sharing tips, even if they are in positions that traditionally do so.

The amendment further provides that a violation of this provision subjects the employer to a civil penalty of up to $1,100 for each such violation, as well as liability to the affected employee(s) for the unlawfully retained tips and an equal amount in liquidated damages. Moreover, if the employer retains tips and takes a tip credit, the penalty also includes loss of the tip credit in addition to disgorgement of the unlawfully retained tips.

To the extent that it precludes employers from keeping tips, the provision is in accord with the 2011 rule. However, in a return to the pre-2011 rule, the amendment will allow employers to require traditionally tipped employees to share their tips with traditionally non-tipped employees — as long as the tipped employees are paid at least the full minimum wage. Furthermore, because *Oregon Restaurant* was based on deference given to the 2011 rule — a rule now invalidated by Congress — that holding presumably is no longer good law and, instead, *Cumbie* is revived. In addition, the DOL's current proposed rule is likely to be deemed moot. Finally, because the amendment does not directly address divergent state law provisions, litigation may arise regarding state law provisions that conflict with the amendment, as employers determine how to resolve that conflict.

To recap, the amendment to the FLSA establishes a compromise between the *Cumbie* rule advocated for by employers and the Obama Administration's 2011 Rule: it permits tip splitting among and with non-supervisory, non-service employees (such as cooks) where no tip credit is taken, but otherwise forbids distribution of tips to such employees when a tip credit is taken, and categorically bans retention of tips by an employer, manager, or supervisor under either scenario.

If you have any questions about this or any other wage and hour issue, please consult the Jackson Lewis attorney with whom you regularly work.