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NINTH CIRCUIT HOLDS THAT EMPLOYERS CANNOT CREATE TIP POOLS WITH BACK OF HOUSE EMPLOYEES

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Due to escalating labor costs as a result of significant increases to the minimum wage and government mandates, such as the Affordable Care Act, hospitality employers are developing creative ways to compensate their employees, particularly for non-service employees. Some employers have eliminated tipping entirely, while others have added certain "surcharges." In fact, where permitted by state law, other employers have kept tipping in place but have expanded tip pools to include non-service employees. Until now it was believed that as long as the employer did not take a tip credit, the Fair Labor Standards Act imposed no impediments on the breadth or dimensions of employer tip pools. Unfortunately, a recent decision by the Ninth Circuit – which covers Alaska, Arizona, California, Guam, Hawaii, Idaho, Montana, Nevada, Northern Mariana Islands, Oregon, and Washington – has now removed a tool that some employers used to compensate non-service employees. On February 23, 2016, in a pair of cases, *Oregon Restaurant and Lodging Association et al. vs. U.S. Department of Labor*, Case No. 13-35765 and *Joseph Cesarz et al. v. Wynn Las Vegas LLC et al.*, Case No. 14-15243 (9th Circuit), the Ninth Circuit upheld the validity of a U.S. Department of Labor Wage and Hour Division (DOL) rule that prohibits tip pools that include non-service employees or managers when an employer does not take a tip credit.

Background

Under the Fair Labor Standards Act (FLSA), tip pooling requirements have been a source of confusion and litigation, especially where employers do not take a tip credit. In 2010, in *Cumbie v. Woody Woo, Inc.*, 596 F.3d 577 (9th Cir. 2010), the Ninth Circuit held that an employer could require servers to pool their tips with kitchen and other "back of the house staff" as well as managers, so long as the employer did not take a tip credit and paid all employees at or above the federal minimum wage. The *Cumbie* Court opined that because the FLSA was silent on tip pool arrangements when no tip credit was taken, an employer could implement any tip pool arrangement it wanted under the FLSA.

After *Cumbie*, the DOL initially announced that it would permit employers in the Ninth Circuit to impose mandatory tip pooling on employees who did not customarily and regularly receive tips (i.e., non-service employees and managers), if the employer did not take a tip credit. However, in 2011, the DOL reversed course and promulgated a rule strictly limiting tip pool participation. Specifically, the DOL issued rules that limit tip pools to those individuals who "customarily and regularly receive tips". In other words, the DOL rule invalidated a mandatory tip pool in which service and non-service (and/or managers) participate, as a violation of the FLSA, irrespective of whether the employer takes a tip credit.

The new rules were promptly challenged. In *Oregon Rest. and Lodging Assn. v. Solis*, No. 3:12-cv-01261 (D. Or. June 7, 2013), a U.S. District Court in Oregon concluded that the DOL had exceeded its authority in issuing the new rules.

In doing so, it relied on *Cumbie* and the silence in the FLSA as related to employers who choose not to take the tip credit. The Oregon court thought *Cumbie* foreclosed the DOL's ability to enact the 2011 rules and that such rules were invalid because it was contrary to Congress's intent. The DOL appealed the court's ruling to the Ninth Circuit.

In a separate case, after enactment of the 2011 DOL rules, casino dealers at the Wynn Las Vegas sued their employer in federal court in Nevada. The *Cesarz v. Wynn Las Vegas, LLC*, No. 2:13-cv-00109 (D. Nev. Jan. 10, 2014) employees claimed that it was a violation of the FLSA for their employer to mandate that the casino dealers participate in a tip pool with non-service employees. Relying on *Cumbie*, the District Court dismissed the complaint holding that because the casino dealers and all other employees in the tip pool were paid at or above the federal minimum wage, there was no FLSA violation. The casino dealers then appealed to the Ninth Circuit.

The Ninth Circuit's Decision

The Ninth Circuit consolidated the two cases and then a divided court reversed both District Court opinions. The Ninth Circuit ruled that the DOL had authority to implement its 2011 regulation addressing tip pools for employers who did not take a tip credit. The majority noted that when an employer takes a tip credit towards its minimum wage obligations to tipped employees, the FLSA requires that any tip pool involving such employees must be limited to those individuals who customarily and regularly receive tips (i.e., service employees). However, the FLSA is silent on the issue of whether a tip pool must consist of only service employees when the employer does not take a tip credit. Therefore, the majority held that pursuant to *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 104 S. Ct. 2778 , 81 L. Ed. 2d 694 (1984), it would defer to the DOL's interpretation of the FLSA provided the interpretation is not "arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 844. The majority also noted that it would defer to the DOL even if the DOL's interpretation is not "the best construction." Accordingly, the Ninth Circuit held that in the absence of any verbiage in the FLSA addressing tip pools when employers pay the required minimum wage and do not take a tip credit, the DOL was free and within its authority to enact the 2011 rules that limit tip pools to service employees.

The majority also specifically addressed the District Courts' reliance on *Cumbie*. The Ninth Circuit noted that nothing in the *Cumbie* decision prevented the DOL from enacting future regulations concerning tip pooling. That is, at the time *Cumbie* was decided, the DOL has not yet enacted a rule prohibiting tip pools among service and non-service workers when the employer does not take a tip credit. Thus, had such a rule been in effect at the time, according to the majority, the outcome of *Cumbie* would have been different.

Practical Implications

Because the DOL regulations apply to all employers, regardless of whether a tip credit is taken, all employers should take this time to review their tip pools to ensure that both in practice and on paper—and in addition to any applicable state or local laws--tips are not being shared with anyone who is not ***regularly interacting with customers***. Indeed, irrespective of applicable state law, it is a violation of the FLSA for tip pools to include managers, kitchen workers, porters, and other non-service employees even when the employer does not take a tip credit and pays its employees well above the federal minimum wage. Employers should review each position to determine if it is a tip pool eligible role and remove any non-tip eligible employees from their tip pools.

Finally, employers are reminded that if they do take a tip credit towards their minimum wage obligations, they must notify the employee, that: (i) the employer is taking a tip credit, (ii) the amount of the tip credit and the cash wage that will be paid, (iii) if the employee's tips and cash wage do not equal the minimum wage the employer will pay the difference, (iv) employees will retain all tips they receive except for valid tip pool arrangement, and (v) the tip credit will not apply unless the employees have been informed of these requirements. It is strongly suggested that such notifications be done in writing.

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