Hospitality
ALERT
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U.S. Department of Labor To Revoke Obama-Era Tip-Pool Restriction Regulation

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Recently, the United States Department of Labor (USDOL) announced that it would begin the process of revoking an Obama-era regulation that restricted which employees could participate in a tip pool. While the revocation of this federal rule is good news for employers in most of the country, it will not have any impact on those employers who operate in New York or California.

The California Labor Code, the New York Hospitality Wage Order and the New York Labor Law already restrict tip-pool participation and such restrictions are not impacted by the USDOL regulation that is being revoked. Accordingly, for New York and California employers, the USDOL's announcement is much ado about nothing.

The USDOL Regulation

In 2011, the Obama administration, pursuant to its alleged authority under the Fair Labor Standards Act (FLSA), issued the following regulation:

> Whether a tip is to be given, and its amount, are matters determined solely by the customer, who has the right to determine who shall be the recipient of the gratuity. Tips are the property of the employee whether or not the employer has taken a tip credit under section 3(m) of the FLSA. The employer is prohibited from using an employee's tips, whether or not it has taken a tip credit, for any reason other than that which is statutorily permitted in section 3(m): As a credit against its minimum wage obligations to the employee or in furtherance of a valid tip pool. Only tips actually received by an employee as money belonging to the employee may be counted in determining whether the person is a "tipped employee" within the meaning of the Act and in applying the provisions of section 3(m), which govern wage credits for tips.

What this regulation essentially states is that employees may only share tips with other employees who are actively engaged in customer service as part of their regular job duties, regardless of whether the employer takes a tip credit with respect to such employees. Thus, under this regulation, regardless of whether employers take a tip credit, employers cannot mandate a tip pool in which front-of-house employees share their tips with back-of-house employees.

The USDOL implemented the regulation after the U.S. Circuit Court of Appeals for the Ninth Circuit issued an opinion in *Cumbie v. Woody Woo, Inc.,* 596 F.3d 581 (9th Cir. 2010) that held that if an employer does not take a tip credit, then the employer could require front-of-house employees to share gratuities with back-of-house employees.

After the USDOL implemented the regulation, it was challenged in various federal courts. The Ninth Circuit held that the regulation was valid. The Tenth and Fourth Circuits held that the USDOL exceeded its authority when it implemented the regulation and thus these two courts invalidated the regulation. The matter has been appealed to the U.S. Supreme Court, but in light of the USDOL's announcement that it would be revoking the rule, it is uncertain whether the Supreme Court will address the issue.

Accordingly, once the rule is revoked, under federal law, if an employer does not take a tip credit, then the employer will be able to mandate how any gratuities left by guests and customers are shared. In

short, if no tip credit is taken, the employer could require front-of-house employees to share gratuities with back-of-house employees.

In fact, once the regulation is revoked, under federal law, if no tip credit is taken, the employer could retain all gratuities left by guests and customers, although there may be serious tax implications (and employee morale issues) should the employer implement such a policy. However, if an employer does take the tip credit, even after the rule is revoked, tips can only be shared with those employees who regularly engage in customer service; back-of-house employees would not be able to participate in the tip pool.

New York and California Law

Under the Hospitality Wage Order and New York Labor Law § 196-d, gratuities left by guests and customers can only be shared with non-managerial employees in similar positions. In effect, this means that food service workers (those employees who spend at least 80 percent of their time engaged in serving food and beverages, such as servers, bussers, runners, bartenders and barbacks) can only share tips with other food service workers.

Similarly, other service employees (e.g., delivery workers, coat check) can share tips only with similar service employees. As such, under New York law, regardless of whether the employer takes a tip credit, front-of-house employees cannot share tips with back-of-house employees.

The revocation of the federal regulation concerning tip pooling does not impact similar prohibitions under New York law. Therefore, once the regulation is officially revoked, New York employers will still be prohibited from establishing tip pools in which front-of-house and back-of-house employees participate.

Further, because California employers are not permitted to take a tip credit, the revocation of the federal regulation will not impact California tip pools. As in New York, under the California Labor Code, California tip pools can only include employees who provide "direct table service" or who are in the "chain of service" and are customer facing.

However, California Labor Code § 351 has been interpreted to permit mandatory tip pooling so long as no owner, manager or supervisor of the business participates in the tip pool (even if these individuals are in the chain of service to a guest).

Other states, such as Massachusetts, place restrictions on who can participate in a tip pool in a manner similar to New York and California.

Takeaways

The USDOL's revocation of the rule prohibiting tip pooling among service and non-service employees is welcome news for employers.

In vast areas of the U.S., if an employer does not take a tip credit, the employer will be able to establish tip pools that generate income for all employees, not just front-of-house employees.

However, employers cannot overlook state laws that may impose restrictions on tip pools irrespective of federal law. New York and California are two such states that prohibit back-of-house employees from sharing tips with front-of-house employees. This prohibition will remain in place unless it is changed by the state legislatures.

Therefore, before employers take advantage of the USDOL's revocation of its tip-pooling regulation, they should consult with counsel before establishing their tip pools to ensure that the tip pools are lawful under state law.

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