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ALERT
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Federal Appellate Court Endorses 80/20 Rule for Tipped Employees

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A federal appeals court has endorsed the U.S. Department of Labor's (DOL) 80/20 Rule, which limits the ability of employers to take a tip credit towards their minimum wage obligations to tipped employees under the Fair Labor Standards Act (FLSA).

In its September 18, 2018, decision in *Marsh v. J. Alexander's LLC*, the U.S. Court of Appeals for the Ninth Circuit upheld a DOL Rule that prohibits employers from taking a tip credit for tipped employees who spend more than 20 percent of their time engaged in non-tip producing activities. The ruling is binding on employers within the Ninth Circuit, which covers Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon and Washington.

Background

In 1966, Congress amended the FLSA to include hotel, restaurant and similar service employees for the first time. However, as part of the amendments, under certain circumstances, Congress permitted employers to take a tip credit towards their minimum wage obligations to tipped employees. Specifically, employers may pay tipped employees a cash wage that is lower than the minimum wage and credit the employees' tips towards the difference between such amounts. As such, currently, under the FLSA, employers may pay tipped employees a cash wage of $2.13 per hour and take a tip credit of $5.12 per hour, provided, among other things, that the employee's tips plus the cash wage equal the minimum wage of $7.25 per hour for all hours worked. The FLSA defines a "tipped employee" as "any employee engaged in an occupation in which he customarily and regularly receives more than $30.00 a month in tips."

After Congress amended the FLSA to include hotel, restaurant and similar service employees, the DOL promulgated two key regulations. First, the DOL explained that "[a]n employee employed full time or part time in an occupation in which he does not receive more than $30 a month in tips customarily and regularly is not a 'tipped employee' within the meaning of [the FLSA]." Second, the DOL issued the dual jobs regulation, which states:

> In some situations, an employee is employed in a dual job, as for example, where a maintenance man in a hotel also serves as a waiter. In such a situation the employee ... is a tipped employee only with respect to his employment as a waiter. He is employed in two occupations, and no tip credit can be taken for his hours of employment in his occupation as a maintenance man. Such a situation is distinguishable from that of a waitress who spends part of her time cleaning and setting tables, toasting bread, making coffee and occasionally washing dishes or glasses. It is likewise distinguishable from the counterman who also prepares his own short orders or who, as part of a group of countermen, takes a turn as a short order cook for the group. Such related duties in an occupation that is a tipped occupation need not by themselves be directed toward producing tips.

This dual job regulation caused confusion among employers within the hospitality industry. Consequently, the DOL released guidance on the

issue in 1988 in its Wage and Hour Division Field Operations Handbook (DFOH). The DFOH, which has been modified over the last thirty years, currently states that when an employee is employed in two separate occupations, one of which is a tipped occupation, the employer may only take a tip credit for the hours an employee spends engaged in the tipped occupation. Further, the DFOH states that DOL regulations permit the employer to take a tip credit for time spent in duties related to the tipped occupation, even though such duties do not produce tips. However, the DFOH goes on to state that if the employee spends more than 20 percent of the employee's time engaged in such non-tip producing activities, then the tip credit cannot be taken when performing such duties. This DFOH guidance is known as the 80/20 Rule.

The DFOH and the 80/20 Rule did not go through notice and comment. As such, the Rule was not promulgated in a manner consistent with the Administrative Procedures Act (APA).

The Ninth Circuit's Decision

In *Marsh,* a server at an Arizona restaurant claimed that he spent much of his time engaged in non-tip producing activities. He claimed that he spent more than 20 percent of his time engaged in activities that were non-tip producing. As such, Marsh contended that his employer violated the 80/20 Rule and the employer could not take a tip credit for time spent engaged in such non-tip producing activities.

Relying on the 80/20 Rule, Marsh filed a collective action lawsuit alleging that his employer violated the FLSA when it took a tip credit for the time he spent engaged in non-tip producing activities. He requested compensation on behalf of himself and all other similarly situated employees equal to the difference between the wages he was paid and Arizona's minimum wage, liquidated damages equal to such amount and counsel fees and costs.

The District Court dismissed Marsh's complaint. The District Court found that, among other things, the 80/20 Rule was not entitled to deference because it did not go through notice and comment as required by the APA. Marsh then appealed to the Ninth Circuit, which initially upheld the District Court's decision. Marsh then requested an *en banc* review in which the entire Ninth Circuit would hear the case rather than a three-judge panel. This request was granted and the Ninth Circuit, *en banc*, reversed the District Court's decision.

The *Marsh* Court found that the dual jobs regulation issued in 1967 was properly promulgated and therefore was entitled to deference under the U.S. Supreme Court's decision in *Chevron, USA, Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984), so-called *Chevron* deference. As such, to the extent that Marsh was engaged in two separate occupations (i.e., server and cleaner), his complaint asserted a valid claim under the FLSA.

Further, following a 2011 decision by the Eighth Circuit (which covers Arkansas, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota), the *Marsh* Court also upheld the validity of the 80/20 Rule. The Ninth Circuit found that the dual jobs regulation was ambiguous. When a regulation is ambiguous, an agency's interpretation of its own regulation is controlling unless such interpretation is plainly erroneous or inconsistent with the regulation. Such deferral to an agency's interpretation of its own regulation is known as *Auer* deference.

The *Marsh* Court found that the 80/20 Rule was a reasonable interpretation of the dual jobs regulation. It was not plainly erroneous and was consistent with the dual jobs regulation and the statute itself. Therefore, it was entitled to *Auer* deference and was thus enforceable. Accordingly, Marsh's complaint alleged a cause of action under the FLSA to the extent he spent more than 20 percent of this time engaged in non-tip producing activities while the employer was taking a tip credit towards its minimum wage obligations to Marsh.

The Impact on Employers

After *Marsh*, employers who take tip credits in the Ninth Circuit must be diligent to ensure that their tipped employees do not spend more than 20 percent of their time engaged in non-tip producing work. This means that employers may want to reassess the side work performed by their tipped employees and perhaps reassign such work to non-

tipped employees. Otherwise, there is a significant risk that employers in the Ninth Circuit, much like employers in the Eighth Circuit, could lose the tip credit if their tipped employees violate the 80/20 Rule. Upon violation of the Rule, employers can still take the tip credit when employees are actually engaged in tip producing work, but such employees must be paid at least the full minimum wage when they are engaged in other work.

Only the Eighth and Ninth Circuits have upheld the validity of the DOL's 80/20 Rule and it is uncertain whether other Circuits will reach the same result. Indeed, at least three members of the U.S. Supreme Court have questioned the validity of *Chevron* deference and *Auer* deference. Further, the DOL's 80/20 Rule does not impact states with their own, stricter 80/20 Rule, such as New York, or states in which it is impermissible for an employer to take a tip credit towards its minimum wage obligations, such as California.

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