Ninth Circuit Validates Rules Prohibiting Inclusion of "Back of the House" Employees in Tip Pools Even for Employers Not Taking a Tip Credit

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Employers in the hospitality industry have been increasingly assessing and updating their tipping practices over the past several years, with some even eliminating tipping all together, affecting both their bottom lines and employee morale. Employers must keep in mind, however, that changes to their tipping practices may also impact their compliance with the federal Fair Labor Standards Act (FLSA) and state and local wage and hour laws.

Until very recently, employers in the hospitality industry who paid workers at least the minimum wage faced uncertainty about whether "back of the house" employees could participate in tip pools, at least in the Ninth Circuit (which covers Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, Washington, and the territories of Guam and the Northern Mariana Islands). On February 23, 2016, the U.S. Court of Appeals for the Ninth Circuit held in *Oregon Restaurant and Lodging Association v. Perez* that—contrary to a prior decision in a 2010 case—only employees who customarily and regularly receive tips may participate in tip pools, regardless of whether the employer relies on a tip credit in compensating its employees.

The legal treatment of "tip pooling"—where an employer collects tips paid to its employees and distributes them among a group of employees—has evolved over the years. Section 203(m) of the FLSA permits employers in the hospitality industry to use their employees' tips to offset a significant portion of their federal minimum wage obligations. Employers utilizing such a "tip credit" are also permitted to require their employees to pool their tips; however, the mandatory pooling of tips must be limited to employees who "customarily and regularly" receive tips, such as waiters, waitresses, bellhops, counter personnel (who serve customers), bussers, service bartenders, and other "front of the house" employees. The statutory language of the FLSA does not address the use of mandatory tip pools by employers who do not take a tip credit and instead directly pay their employees at least the minimum wage without relying on tips.

In 2010, the Ninth Circuit held in *Cumbie v. Woody Woo, Inc.*, 596 F.3d 577 (9th Cir. 2010), that Section 203(m) did *not* restrict the tip pooling practices of employers who did not take tip credits because the statute was silent with respect to such employers. Reading Section 203(m) to apply only to those employers taking a tip credit, the Ninth Circuit held that employers not taking a tip credit could include in mandatory tip pools both "front of the house" employees and employees who do not customarily and regularly receive tips, such as dishwashers, cooks, chefs, janitors, and other "back of the house" employees.

Not long after the *Cumbie* decision, in 2011, the U.S. Department of Labor (DOL) promulgated a formal rule clarifying that the inclusion of employees who do not regularly receive tips in a tip pool violates Section 203(m) regardless of whether an employer takes a tip credit. Concluding that, as written, Section 203(m) contained a "loophole" through which employers could exploit the FLSA tipping provisions, the DOL revised 29 C.F.R. § 531.52 to read as follows:

> Tips are the property of the employee whether or not the employer has taken a tip credit under section [20]3m 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 [20]3(m): As a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool.

Following the DOL's issuance of its 2011 rule, two U.S. District Courts in Ohio and Nevada held that the Ninth Circuit's *Cumbie* decision left "no room" for the DOL to promulgate such rule and that the rule was invalid because it was contrary to Congress' clear intent. In *Oregon Restaurant and Lodging Association*, a divided three judge panel of the Ninth Circuit Court of Appeals disagreed and upheld the DOL's tip pooling regulation as a valid and reasonable exercise of its authority to pass regulations interpreting the FLSA. The decision thus overruled *Cumbie* in reliance on the DOL's intervening regulation.

This decision may not be the end of the road for this issue in the Ninth Circuit, where *en banc* review may be sought, or elsewhere. In the meantime, however, employers who do not take a tip credit must understand that, according to the DOL, and now one U.S. Court of Appeals, mandatory tip pools may include *only* those employees who customarily and regularly receive tips. Employers are encouraged to review their current tip pooling practices and procedures to confirm compliance with the FLSA and state and local wage and hour laws.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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