

Restrictive Department of Labor tip credit and tip pooling regulations struck down

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SUMMARY

The Department of Labor's regulation requiring that regardless of the amount of wages paid, tips were the property of the employees, has been struck down by a federal court. Employers covered by the Court Order may now pay a wage above the minimum wage and require employees to turn over all or a portion of tips to the employer to defray its wage or other costs.

What Happened?

Since its enactment in 1938, the Fair Labor Standards Act ("FLSA") has required employers to pay all covered "non-exempt" employees the mandated minimum wage. One exception to this general requirement is for "tipped employees." The exception provides that for employees who customarily and regularly receive tips – including those participating in a valid "tip pool" – the employer could lawfully pay "tipped employees" a reduced amount set by Congress (now \$2.13) and take a credit for tips actually received. This was lawful so long as the amount of total compensation from wages paid and tips equaled or exceeded the federal minimum wage.

Some employers – most notably those in states that have minimum wage laws that do not permit tip credits – elected to pay a direct wage at or above the minimum wage and then keep all or a portion of the tips to offset that cost. Historically, this approach has been permissible under the FLSA.

In April 2011, however, the U.S. Department of Labor, as part of an aggressive regulatory effort to rewrite existing law, declared such arrangements unlawful. The new regulation required that regardless of the amount of wage paid directly by the employer, all tips received were the property of employees and could not be touched by the employer.

Earlier this month, that regulation was struck down by a U.S. District Court in Oregon, based on precedent from the U.S. Court of Appeals for the 9th Circuit (covering West Coast states), that the Department of Labor ("DOL") specifically chose to ignore in promulgating its 2011 regulation. The court's final order prohibits the DOL from applying the regulation to members of the associations that brought the suit challenging the regulations: Oregon Restaurant & Lodging Ass'n, Alaska CHARR and the National Restaurant Ass'n. Whether the DOL will pursue non-members of those groups is unknown.

What Does It Mean?

While this case obviously is significant for the plaintiffs who filed the suit, the case has broader significance because it reflects a growing pattern of cases where the federal courts are rejecting reinterpretation of old laws by Obama administration labor agencies.

For the industry the impact is this: Most restaurants in the East are permitted by state law to adopt the "tip credit" model, and they generally do so. They pay the small direct wage required by federal or state law and distribute (in the case of a "tip pool" and credit card tips collected by the restaurant) and/or allow tipped employees to retain all of their tips. For those establishments, the 2011 regulations had no real impact and nothing changes with the demise of the regulations.

For establishments which choose to do so, for example, where tips are generally small or where there is a workforce that does not wish to rely on tips, the employer – or at least National Restaurant Association members - may now pay a wage above the minimum wage and require employees to turn over all or a portion of tips to the employer to defray its wage or other costs.

One last note, however, is that DOL does require notification to employees if a tip pool is used and details of how it operates. Moreover, DOL has not yet made clear whether it will abide by this ruling; employers should be aware that DOL may

still apply its current regulation and pursue those not covered by its order who do not conform.

For more information on this important development, feel free to contact the author or the Saul Ewing attorney with whom you regularly have contact.

This Alert was written by Edward R. Levin, a member of the firm's Labor, Employment and Employee Benefits Practice. Edward can be reached at 202.342.3420 or elevin@saulewing.com. This publication has been prepared by the Labor, Employment and Employee Benefits Practice for information purposes only.

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