

**DIPPING INTO THE TIP POOL: RESTAURANT WORKERS  
AND THE FLSA**

**EMERGING ISSUES IN EMPLOYMENT LAW TRACK  
THE NEW ERA OF ENFORCING WORKERS' RIGHTS  
UNDER THE FLSA**

**NELA 18<sup>TH</sup> ANNUAL CONVENTION  
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**I. INTRODUCTION**

This paper seeks to provide NELA members law with an introduction to the most common claims arising from the application of the FLSA to the restaurant/food service industry. Specifically, this paper will discuss tipped employees and the FLSA claims that are frequently associated with them, including tip pooling violations.

The restaurant industry and its tipped employees are attractive candidates for litigation under the FLSA. First, the United States Department of Labor (“DOL”) has recently focused its attention on the restaurant industry in an effort to protect low wage workers in a sector of the economy characterized by “persistent and serious violations.” See Department of Labor Annual Report, Fiscal Year 2005, Performance and Accountability Report. In particular, the DOL has prioritized compliance and enforcement activity in low-wage industries like restaurants. Id.

Second, this type of litigation provides practitioners the opportunity to represent low wage workers in a major component of our national economy. Accordingly to the Bureau of Labor Statistics, there are an estimated 10.8 million employees in the restaurant industry, which

comprises over 8% of the total national workforce. U.S. Department of Labor Bureau of Labor Statistics, May 2005 National Occupational Employment and Wage Estimates available at [http://www.bls.gov/oes/current/oes\\_nat.htm#top](http://www.bls.gov/oes/current/oes_nat.htm#top). Not only does this litigation permit plaintiff attorneys the chance to assist an under-served segment of the population, but it also provides a large pool of potential clients and the opportunity to bring law enforcement (FLSA) to this often lawless sector of our increasingly service oriented economy.

## **II. THE LAW**

### **A. Who is a “Tipped Employee”?**

A “tipped employee” is defined as an employee engaged in an occupation who customarily and regularly receives more than \$30 a month in tips. 29 U.S.C. § 203(t). In addition, the following requirements must be met.

First, a tip is money presented by a customer as a gift or gratuity in recognition of service s/he received. 29 C.F.R. § 531.52. Thus, compulsory charges for service are not considered tips for purposes of the FLSA. 29 C.F.R. § 531.55.

Second, unless otherwise arranged, a tip becomes the property of the employee that it was presented to and given in recognition of a service rendered. 29 C.F.R. § 531.52. However, this does not mean that the tip belongs exclusively to whichever employee first gathers the tip. As will be discussed later, tip pooling is based on the idea that tips left by customers can be intended for more employees than just the servers. For instance, bussers are considered tipped employees because they provide a service that customers recognize with their tips and receive these tips, usually through a tip pooling arrangement. 29 C.F.R. § 531.54.

Third, only tips received by the employee, which are free of any control by the employer, may be considered in determining tipped employee status. 29 C.F.R. § 531.52. In other words, no portion of an employee’s tips may be used as a kick back directly or indirectly to the employer. 29 C.F.R. § 531.35.

Finally, “customarily and regularly” signifies a frequency that must be greater than occasional but may be less than constant. 29 C.F.R. § 531.57.

While the determination of whether a particular employee qualifies as a tipped employee varies based on the individual circumstances of the case or the community in question, the regulations recognize certain positions that are traditionally considered tipped positions. These occupations include, but are not limited to, waiters/waitresses, bellhops, counter personnel who serve customers, busboys/girls, and service bartenders. See Department of Labor Field Operations Handbook (“Handbook”) § 30d04(a) (1988). Similarly, the regulations delineate positions that are typically not tipped occupations, which include janitors, dishwashers, chefs, cooks, and laundry room attendants. Id. at § 30d04(c). While these titles are not necessarily dispositive, they often provide a backdrop for comparison with a contested or alleged tipped occupation.

#### **B. Tip Credits**

Under the FLSA, an employer may utilize a tip credit to pay tipped employees a direct wage less than minimum wage. The tip credit is defined as a legally permitted portion of the statutory minimum wage that an employer is excused from paying because its tipped employees have earned a certain amount of money in tips. With the current federal minimum wage at \$5.15 per hour, employers may pay their tipped employees as little as \$2.13 per hour as long as their employees earn at least \$3.02 per hour in tips. 29 U.S.C. § 203(m). However, some states do not permit employers to use a tip credit or pay a sub-minimum wage, including California, Alaska, Minnesota, Montana, Nevada, Oregon, Washington, and Guam. See State Tip Credit Chart attached as Exhibit A.

Three conditions must be met in order for an employer to qualify for a tip credit. First, the employer must notify the employees of its intention to use the tip credit. 29 U.S.C. § 203(m). While the statute and the regulations do not specify the type or content of required notice, most courts have viewed this requirement permissively and find adequate notice so long as the

employee was informed of the tip credit, while not necessarily requiring any explanation. See Kilgore v. Outback Steakhouse of Florida, Inc., 160 F.3d 294, 299-300 (6<sup>th</sup> Cir. 1998) (written statement describing use of tip credit was sufficient notice); Davis v. B & S, Inc., 38 F.Supp.2d 707 (N.D. Ind. 1998) (sufficient notice provided where co-worker informed plaintiff of tip credit arrangement); but see Bonham v. Copper Cellar Corp., 476 F. Supp. 98, 101 (E.D. Tenn. 1979) (holding that hanging of poster in non-prominent location with vague conversations about minimum wage did not constitute notice of tip credit); Chan v. Sung Yue Tung Corp., 2007 WL 313483 (S.D.N.Y.) (finding hanging of poster in language that most employees did not understand was not sufficient notice).

Second, all tips received by the employee must be retained by him/her, except with respect to valid tip pools. 29 U.S.C. § 203(m). As mentioned above, an employer may not collect any of the employees' tips if it intends to use the tip credit allowance.

Third, the employee must receive at least minimum wage when the direct wages and tips are combined. Id. Currently, employers are required to provide at least \$2.13 per hour in direct wages to tipped employees, which means they may claim a tip credit of \$3.02. However, if the actual tips earned by an employee are less than \$3.02 per hour, the employer is required to make up the difference and ensure that the employee receives the federal minimum wage.

### **C. Tip Pooling**

Tip pooling is the practice of gathering gratuities or a partial amount of those gratuities received from customers in a central pool for distribution to other employees. In order for a tip pool to be valid, several conditions must be met: 1) it must only involve tipped employees, 2) apply only to tips collected by the employees, 3) cannot result in employees receiving a sub-minimum wage, and 4) the contribution amounts must be "customary and reasonable." 29 U.S.C. § 203(m); Handbook at § 30d04.

The phrase "customary and reasonable" is not defined in the regulations, but has been interpreted by the DOL to mean that employers cannot require employees to contribute

more than 15% of their net tips. See Wage and Hour Division United States Department of Labor Opinion Letter (“Opinion Letter”), WH-468 (September 5, 1978); Handbook at § 30d04(b). However, some courts have disregarded the DOL’s interpretations as non-binding and found tip pool contributions greater than 15% of the employees’ net tips to be customary and reasonable. See Kilgore, 160 F.3d at 302-304 (finding tip pool that required servers to contribute 3% of their total sales or roughly 37.5% of their net tips customary and reasonable).

It is important to note that tip pools need not be voluntary so long as the requirements described above are met. See Bonham v. Copper Cellar Corp., 476 F. Supp. 98, 101 (E.D. Tenn. 1979).

### **III. TYPICAL CLAIMS ARISING FROM TIPPED EMPLOYEES**

#### **A. Improper Tip Pooling**

The most common claim under the FLSA associated with tipped employees is an improper tip pool. These tip pools usually involve the prohibited participation of either owners/managers or non-tipped employees.<sup>1</sup> In the event that an employer is found to have instituted an improper tip pool, the consequence is that it may not use the tip credit allowance for any of the tipped employees participating in the tainted tip pool.<sup>2</sup>

##### **1. Owners/Manager Participation**

As mentioned before, employers are not permitted to receive any portion of tipped employees’ collected gratuities. See 29 C.F.R. § 531.35. Under the FLSA, an employer “includes any person acting directly or indirectly in the interest of an employer in relation to an employee.” 29 U.S.C. § 203(d). Thus, if an employer or its agent partakes in a tip pool arrangement, the tip pool is illegal.

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<sup>1</sup> Other types of improper tip pools include those that require contributions that are not reasonable or customary or those that fail to provide adequate notice. As these theories have already been discussed, they will not be repeated here.

<sup>2</sup> The scope of available damages will be discussed further in Section III.B.

To assist the determination of whether a party is an employer or its agent for purposes of this analysis, many courts utilize the “economic reality” test, which considers “whether the alleged employer (1) had the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records.” Carter v. Dutchess Cmty. Coll., 735 F.2d 8, 12 (2d Cir. 1984). Under this test, no one factor is dispositive and control may be exercised on a periodic basis without eliminating employer or employer agent status. Herman v. RSR Sec. Servs., Ltd., 172 F.3d 132, 139 (2d Cir. 1999).

Several courts have utilized this analysis to conclude that the involvement of various managers or owners in server tip pools was illegal. In Ayres v. 127 Restaurant Corp., 12 F.Supp.2d 305 (S.D.N.Y. 1998), the court found that an individual upon being promoted to general manager of the restaurant became an agent of his employer and thus, an improper participant of the contested tip pool because he had full authority to suspend, terminate, and hire, assumed greater responsibility of the restaurant’s budget, and received a weekly salary irrespective of his hours worked. Id. at 307-308. Similarly, in Chung v. New Silver Palace Restaurant, Inc., 246 F.Supp.2d 220 (S.D.N.Y. 2002), the court found the tip pool tainted where it included the participation of “black jackets.” Because these “black jackets” included major shareholders and board members of the restaurant, exercised hiring and firing powers, and had direct supervisory power over the waiter, the court concluded that they were employers under the FLSA and thus could not share in the waiter tip pool. Id. at 228-29. See also Chan v. Sung Yue Tung, Corp., 2007 WL 313483 at \*12-13 (finding that owners, officers, and managers of the restaurant improperly participated in the server tip pool).

However, not all managers are considered employers or agents of their employers under this analysis. In Davis v. B&S Inc., 38 F.Supp.2d 707, 715-17 (N.D. Ind. 1998), the court determined that a General Manager at an adult nightclub did not constitute an employer for purposes of the FLSA. In that case, the court credited the General Manager’s testimony that while he had some supervisory power, he did not have authority to hire or fire employees, did

not control the methods of operating the business, and was also persuaded by the fact that he was acting in his own interests rather than those of his employer in accepting tips. Id.

## **2. Non-tipped Employee Participation**

Another type of improper tip pooling arises when non-tipped employees participate in a mandatory tip pool. As discussed above, the traditionally understood positions that qualify as tipped employee positions are waiters/waitresses, bellhops, counter personnel who serve customers, busboys/girls, and service bartenders. See Handbook at § 30d04(a). The developing area of the law for these type of claims focuses on other restaurants positions and whether they are properly considered tipped employees or not.

Most courts look to the degree of customer contact and whether the duties of the position are viewed as traditional food preparation or actual service in determining tipped employee status. Employees with limited or no customer contact and who primarily assist in the preparation of the dishes should not be included in tip pools, while those who have significant customer interaction can be included. In Myers v. The Copper Cellar Corp., 192 F.3d 546 (6<sup>th</sup> Cir. 1999), the Sixth Circuit held that an employer's tip pool was improper because it included salad makers who did not have any direct interaction with the diners, labored out of the view customers, and performed duties typically classified as food preparation or kitchen work. See also Elkins v. Showcase, 704 P.2d 977 (Kan. 1985) (interpreting the FLSA and finding non-service bartenders were improperly included in tip pool because they were physically separated from the patrons and did not have any direct customer contact). A year prior, the same court applying the same test held that hosts were tipped employees and properly included in tip pools. See Kilgore, 160 F.3d at 301-302. In Kilgore, the court found that the hosts sufficiently interacted with clients by greeting them, supplying them with menus, seating them, and occasionally enhancing the wait by delivering food or drinks, which it considered more similar to the duties of servers and bussers rather than cooks or food preparation staff. Id.

However, establishing that a non-tipped employee participates in a tip pool does not constitute a per se violation of the tip pool. Instead, a key element in bringing this type of an improper tip pooling claim requires also establishing that the tipping out of these non-tipped employees was not voluntary. The DOL has consistently interpreted the FLSA as not prohibiting tipped employees from voluntarily sharing their tips with individuals of their choosing, so long as such decisions are free of coercion, control, or involvement by the employer. See Opinion Letter WH-380 (March 26, 1976). Thus, the inclusion of non-tipped employees in a tip pool only violates the FLSA when a plaintiff can establish that tipping these employees out is required and not voluntary.

Some employers have sought to exploit the voluntary test by declaring the tipping out of these non-tipped positions to be voluntary while indirectly assisting its continuation and/or relying upon co-worker peer pressure to functionally force tipped employees to tip out. Despite this creativity, there is some indication that this arrangement may not be a defense. See Opinion Letter (November 4, 1997) (suggesting that tip pool may not be voluntary even though the employer does not mandate a contribution, if it recommends certain tip out amounts and relies upon peer pressure to ensure that the tip pooling occurs).

## **B. Damages**

In the event a tip pool is found improper, the employer is no longer eligible for the tip credit and must pay the tipped employees the balance of the minimum wage per hour for all hours worked while contributing to the tainted tip pool. 29 U.S.C. § 203(m); Opinion Letter (November 4, 1997); New Silver Palace, 246 F.Supp.2d at 230-31 (requiring employer to pay the difference between the federal minimum wage and the hourly wages actually paid where it required an improper tip pool). Under the federal minimum wage, an employer therefore would be liable for \$3.02 for each hour worked by each tipped employee. When aggregated for an entire store or nationwide restaurant chain, this revocation of the tip credit over a three year liability period can result in a sizeable award.



Restitution under the FLSA may also be available as a remedy for plaintiffs. A district court in New York has allowed plaintiffs to recover their improperly shared tips in addition to their recovery of the tip credit. Chan v. Sung Yue Tung Corp., 2007 WL 313483 (S.D.N.Y.) (stating that “Plaintiffs are also entitled to recover the amount of tips that the defendant illegally retained”). Alternately, restitution may be available under certain state laws. See Matoff v. Brinker Restaurant Corp., 439 F.Supp.2d 1035, 1038-39 (C.D. Cal. 2006) (under California law, permitting plaintiffs to seek restitution of allegedly improper tip outs against the employer even though the tips were given to the bartenders and not the employer).

In addition, plaintiffs will likely be entitled to liquidated damages for violations of minimum wage and overtime provisions of the FLSA as they are the norm rather than the exception. See 29 U.S.C. § 216(b); Reich v. Southern New England Telecomms., 121 F.3d 58, 71 (2d Cir. 1997) (explaining that “[d]ouble damages are the norm, single damages the exception”) (internal citations omitted). However, an employer can avoid having to pay them if it meets the difficult burden of proving that it acted in “good faith” and had “reasonable grounds” for believing its actions did not violate the FLSA. 29 U.S.C. § 260; Moon v. Kwon, 248 F.Supp.2d 201, 234 (S.D.N.Y. 2002). To satisfy this requirements, an employer cannot merely claim ignorance and instead must have taken “active steps to ascertain the dictates of the FLSA and then move[d] to comply with them.” Southern New England Telecomms., 121 F.3d at 71 (internal citations omitted).

### **C. Other Related Claims**

In addition to improper tip pooling claims, several other common related claims crop up in connection with tipped employees, including reimbursement for uniform laundering costs, excessive charging for employer provided meals, reimbursement for credit card transaction fees, and miscalculation of overtime rate.<sup>3</sup>

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<sup>3</sup> This is by no means an exhaustive list of possible related claims involving tipped employees, but rather only the most common.

A common claim in the restaurant industry involves the requirement that employees reimburse their employers the costs of uniforms or uniform maintenance. An employer may not impose the cost of doing business upon its tipped employees, in the form of charging them for the costs of laundering garments where the employer has a policy requiring the wearing of clean uniforms, if doing so would reduce their wages below minimum wage. See 29 C.F.R. §§ 531.3(d)(2), 531.32(c); Opinion Letter, FLSA2006-21 (June 9, 2006). Because an employee's tips may not be kicked back to the employer and are their sole property, the employer must pay its tipped employees no less than \$2.13 per hour in direct wages to satisfy the federal minimum wage and thus, cannot use any of the required sub-minimum direct wage to offset costs of laundering.<sup>4</sup>

Where employers provide their employees with required meals in lieu of payment of part of their direct wages, a claim can arise if the employer charges a meal credit to its employees more than the actual cost of these meals. In Herman v. Collis Foods, Inc., 176 F.3d 912, 918 (6<sup>th</sup> Cir. 1999), the court held that the deductions imposed by the employer for the cost of meals, which it customarily furnished required meals to its employees, were legal because they did not exceed the reasonable cost of the meals provided.<sup>5</sup>

Another common issue involving tipped employees centers on employees bearing the costs of credit card transaction fees. The theory of this claim is that the employer's deduction of credit card service charges from earned credit card tips runs afoul of the requirement that employees to retain all of their tips. However, most courts do not recognize this claim. In Myers

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<sup>4</sup> However, an employer is permitted to deduct the costs of laundering if it pays a direct wage greater than \$2.13 per hour and where the deduction would not drop the tipped employees' direct wages below \$2.13 per hour. See Opinion Letter, FLSA2006-21 (June 9, 2006).

<sup>5</sup> It is noteworthy that the court also found that these meal deductions did not have to be voluntary to be valid, so long as the employer customarily provided meals and did so at a reasonable price. This holding is directly contrary to the regulations, but increasingly is an approach adopted by the courts. Compare Archi v. Grand Central Partnership, Inc., 86 F.Supp.2d 262, 267 (S.D.N.Y. 2000) with 29 C.F.R. § 531.30 ("Not only must the employee receive the benefits of the facility for which he is charged, but it is essential that his acceptance of the facility be voluntary and uncoerced").

v. The Copper Cellar Corp., the court concluded that tipped employees are only “entitled to receive the cash proceeds of the charged tip *net of liquidation expenses*” and thus, the employer could first deduct the credit card transaction fees from those credit card tips. 192 F.3d at 554 (emphasis in original); see also Bollenberg v. Landry's Restaurant, 2005 WL 2121810 (S.D. Tex.) (same). The Myers court did, however, note that the deduction must not exceed the actual service charges of the credit card charges, but allowed the employer to establish this fact in the aggregate rather than requiring it to establish that the deductions matched each transaction. 192 F.3d at 555-56.

Finally, a common error made by employers is miscalculating tipped employees’ overtime rate based off the sub-minimum direct wage it pays rather than the full minimum wage rate. Pursuant to 29 C.F.R. § 531.60, a tipped employee’s regular rate combines the employer’s direct wages (including service charges), the tip credit claimed, as well as “the reasonable cost or fair value of any facilities furnished him by the employer.” See also Opinion Letter (December 29, 1997) (stating that service charges constitute direct compensation from the employer and must be included in calculating employees’ regular rates for purposes of overtime). Failure to include either the tip credit used by the employer or any of these other components in calculating a tipped employee’s regular rate is thus, illegal.

#### **D. State Law Claims**

Many states have laws that provide greater protection of tipped employees than the FLSA and even allow claims not available under federal law. See State Tip Credit Chart, Exh. A. For instance, under California law, employers are not permitted to use a tip credit for tipped employees. See Henning v. Industrial Welfare Com., 252 Cal.Rptr. 278, 288-89 (Cal. 1988); Leighton v. Old Heidelberg, Ltd., 268 Cal.Rptr. 647 (Cal. Ct. App. 1990). In addition, California employers may not take credit card processing fee deductions from the credit card tips earned by employees. See Cal. Labor Code § 351 (“An employer that permits patrons to pay gratuities by credit card shall pay the employees the full amount of the gratuity that the patron indicated on

the credit card slip, without any deductions for any credit card payment processing fees or costs that may be charged to the employer by the credit card company”).

#### **IV. LOOKING FORWARD**

The outlook for these types of claims is quite encouraging. The new wave of litigation surrounding the issue of tip pooling has arisen in response to employers’ and in some cases entire industries’ attempts to save money in the form of sub-minimum wages by improperly requiring the inclusion of non-tipped employees in their tip pools. For instance, in Chou v. Starbucks Corp., Case No. Case No. GIC 836925 (San Diego Super. Ct.) the plaintiffs allege that the barista tip pool should not include shift supervisors, while Roussell v. Brinker International, Inc., Civil Action No. 4:05-CV-03733 (S.D. Texas), focuses on allegations of that Chili’s improperly includes Quality Assurance employees or Expeditors, who are responsible for arranging the plated food and remain in the kitchen area, in their server tip pools. Given the clear legal authority on this topic, these arrangements provide a fertile ground for bringing improper tip pooling claims under the FLSA and at times, state laws. As an added bonus, these claims create manageable class/collective action cases suitable for whatever scope or complexity plaintiffs’ attorneys are willing to take on. Counsel may seek to litigate a statewide, regional, or nationwide case against large chain restaurant employers<sup>6</sup> or a smaller firm may choose to take on more limited case against a single large local restaurant or restaurants in a specific town or city.

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<sup>6</sup> It is advisable to associate a team of attorneys if taking on a case of this magnitude.

## SELECTED BIBLIOGRAPHY<sup>7</sup>

### STATUTES AND REGULATIONS

- 29 U.S.C. § 203(m) and (t)
- 29 C.F.R. §§ 531.50 – 531.59

### UNITED STATES DEPARTMENT OF LABOR REFERENCE MATERIALS

- U.S. Department of Labor Field Operations Handbook § 30d (December 9, 1988)
- U.S. Department of Labor, Employment Standards Administration Wage and Hour Division, Fact Sheet #15: Tipped Employees Under the Fair Labor Standards Act (FLSA)

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<sup>7</sup> For more articles on wage/hour topics, go to [www.gdblegal.com](http://www.gdblegal.com) (click on the “Resources” link and then “Articles”). Many of the authors’ papers from past NELA, CELA, and ABA programs can be accessed directly from the firm’s website.