The Federal Tip Credit Under Fire: How Do You Properly Pay Tipped Employees?

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TABLE OF CONTENTS

I. SCOPE OF ARTICLE

This article provides an overview of the Fair Labor Standards Act's tip credit provision, with particular focus on ongoing litigation involving the scope of permissible duties performed by tipped employees. This article is limited to the federal tip credit provision, and does not discuss any state or local tip credit provisions. Please note, however, that some states (including Alaska, California, Minnesota, Montana, Nevada, Oregon and Washington) do not permit a tip credit toward state minimum wage obligations, and some states have tip credit provisions that are inconsistent with federal law. (For a summary of state tip credit provisions prepared by the U.S. Department of Labor, see www.dol.gov/whd/state/tipped.htm#foot3). Employers are generally required to comply with the applicable law that is most favorable to employees. *See* 29 U.S.C. § 218(a). Accordingly, employers should carefully consider both federal and state/local law in establishing pay practices.

II. HISTORICAL CONTEXT

A. History of The FLSA's Minimum Wage and Overtime Requirements

The Fair Labor Standards Act (FLSA) was enacted in 1938 to address "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well being of workers." 29 U.S.C. § 202(a). The FLSA's basic requirements are deceptively simple: employees must be paid a minimum hourly rate for all hours worked, and must be paid overtime compensation at a rate of one and one-half times the regular rate for any hours worked in excess of 40 each week. 29 U.S.C. §§ 206(a), 207(a)(1). In practice, however, the FLSA can be one of the most confusing and confounding of the laws regulating the employment relationship, in part due to the numerous exceptions and exemptions from the basic minimum wage and overtime requirements.

In addition, unlike many other employment laws, the FLSA creates a form of strict liability. As a general rule, an employer is liable for failure to comply with the FLSA regardless of the employer's good faith intent or efforts at compliance (although good faith may reduce the amount of damages). Moreover, the FLSA is generally construed narrowly against employers. Thus, careless or innocent mistakes may subject an employer to significant liability.

Against this backdrop, some employee advocates contend that employers routinely ignore and even intentionally disregard the FLSA. For example, a recent survey concluded that wage and hour violations are rampant in low wage industries. In 2008, a group of about a dozen professors and researchers surveyed over 4,000 workers in Chicago, Los Angeles and New York City.[1] The group's findings paint a very bleak picture of the American workplace:

[1]"Broken Laws, Unprotected Workers," http://www.unprotectedworkers.org/index.php/broken_laws/index. Survey participants were recruited through a sampling technique known as chain-referral. Researchers made contact with a relatively small group of low wage workers ("seed participants") in each of the three metropolitan areas. Each of the seed participants was paid $30 to $50 for completing a survey, and was also provided a stack of coupons to distribute to other individuals encouraging them to participate in the survey. The seed participants received additional compensation for each coupon recipient who completed the survey. The coupon recipients who responded were paid for their own participation in the survey, and were given a stack of coupons of their own. According to the researchers, this networking of referrals produced a diverse sample, independent of the initial sample of seed participants.

- Twenty-six percent of surveyed workers were paid less than minimum wage.
- Over one-fourth of respondents worked in excess of 40 hours, but 76% of those individuals were not paid the required overtime premium.
- About one-fourth of the respondents performed work before or after their scheduled shifts, but 70% of those individuals received no additional pay for the additional work.
- Thirty percent of tipped employees surveyed were not paid the appropriate tipped wage rate.
- Twelve percent of tipped workers experienced "tip stealing" by their supervisors.
- In the 12 months preceding the survey, 44% of the survey respondents experienced some form of pay violation (off-the-clock work, late pay, or less pay than owed).

The study also quantified results by industry and by occupation. The survey found minimum wage violations for 18% of restaurant and hotel employees, including 30% of hotel housekeepers, 23% of back of the house restaurant workers, and 9% of servers and bartenders.

Overtime violations were found to be far more pervasive, affecting 70% of restaurant and hotel employees, led by servers and bartenders at 78% and back of the house restaurant workers at 68%.

The study also found 74% of restaurant and hotel employees were subjected to off the clock violations, with back of the house restaurant employees at 73% and servers and bartenders at 68%.

Although the survey's methodology and conclusions may certainly be challenged, the survey provides a clear picture of how employee advocates view the wage-and-hour world. This view is further underscored by the current litigation climate. Increasingly, employees are banding together to assert wage and hour claims in the form of class actions and FLSA collective actions. Although potential exposure for failure to properly pay any one employee is relatively small, exposure is very real and very significant if one employee's claims are joined with similar claims by hundreds or thousands of coworkers. In short, wage and hour compliance has never been more important than it is right now.

B. History of The FLSA's Tip Credit Provision

As originally enacted, the FLSA did not apply to workers in restaurants, hotels, and certain other retail and service industries. *See* S. Rpt. No. 89-1487, 1966 U.S.C.C.A.N. 3002, 3014-15 (August 23, 1966); Pub. Law 89-601. In 1966, Congress amended the FLSA to extend coverage to restaurant and hotel workers. At the same time, Congress also inserted the tip credit provision to ease the economic impact on employers, and permit the continuance of certain existing payroll practices with respect to tipped employees. *Id.*; 29 U.S.C. § 203(m) and (t).

The tip credit provision originally allowed employers to pay tipped employees one-half the minimum wage rate, and to take a credit for tips received by the employee to satisfy the remaining minimum wage obligation. *See* Pub. L. 89-601, § 101(a). Congress amended the percentage of the tip credit several times until, in 1996, the wage rate for tipped employees was fixed at $2.125 per hour (typically rounded to $2.13 per hour), with a tip credit allowed for the balance of the minimum

wage obligation. As the minimum wage rate has continued to increase, so has the amount of the tip credit. Presently, employers may take a tip credit of as much as $5.12 (the difference between the $7.25 federal minimum wage and the $2.13 tipped wage rate).

III. STATUTORY REQUIREMENTS FOR THE TIP CREDIT

Under the FLSA's tip credit provision, and subject to certain limitations, employers may pay tipped employees a cash wage of as little as $2.13 per hour, so long as tips received by the employee make up the difference between the cash wage and the applicable minimum wage. Despite this relatively simple concept, the FLSA's statutory language is rather convoluted:

> In determining the wage an employer is required to pay to a tipped employee, the amount paid such employee by the employee's employer shall be an amount equal to –
>
> > (1) the cash wage paid such employee which for purposes of such determination shall be not less than the cash wage required to be paid such an employee on August 20, 1996 [i.e., $2.13 per hour]; and
> >
> > (2) an additional amount on account of the tips received by such employee which amount is equal to the difference between the wage specified in paragraph (1) [$2.13 per hour] and the wage in effect under section 206(a)(1) of this title [presently $7.25 per hour].
>
> The additional amount on account of tips may not exceed the value of the tips actually received by an employee. The preceding 2 sentences shall not apply with respect to any tipped employee unless such employee has been informed by the employer of the provisions of this subsection, and all tips received by such employee have been retained by the employee, except that this subsection shall not be construed to prohibit the pooling of tips among employees who customarily and regularly receive tips.

29 U.S.C. § 203(m).

"Tipped employee" is defined as "any employee engaged in an occupation in which he customarily and regularly receives more than $30 a month in tips." 29 U.S.C. § 203(t).

These statutory provisions may be distilled down to the following requirements for the taking of the tip credit:

> (1) employees must be engaged in an occupation in which they customarily and regularly receive more than $30 a month in tips;
>
> (2) employees must be paid a cash wage of at least $2.13 per hour;
>
> (3) tips received by employees must make up the difference between the cash wage and the minimum wage;

(4) tips may not be used to satisfy the overtime premium requirement;

(5) the employer must inform employees of the FLSA's tip credit provision; and

(6) employees must retain all tips, other than those contributed to a valid tip pool.

Courts have held that employers bear the burden of proving that these statutory requirements have been met. *See, e.g., Bernal v. Vankar Enterprises, Inc.*, 579 F. Supp. 2d 804, 808 (W.D. Tex. 2008).

Each of these requirements is discussed briefly below, but the focus of this article is on the first requirement – that an employee be engaged in a tipped occupation. This aspect of the tip credit, which has been the subject of a flurry of recent litigation and remains an area of uncertainty, is discussed in detail at section IV below.

A. Employees Must Customarily and Regularly Receive at Least $30 a Month in Tips

"A tip is a sum presented by a customer as a gift or gratuity in recognition of some service performed for him. It is to be distinguished from payment of a charge, if any, made for the service. Whether a tip is to be given, and its amount, are matters determined solely by the customer, and generally he has the right to determine who shall be the recipient of his gratuity." 29 C.F.R. § 531.52.

A compulsory service charge that is automatically added to the bill is not a tip, even if the amount of the service charge is given to the employee. 29 C.F.R. § 531.55(a). Although service charges cannot be counted as tips received by the employee, the employer may use service charges to satisfy part or all of the cash wage requirement. 29 C.F.R. § 531.55(b).

Where employees engage in tip sharing or pooling arrangements, employees are deemed to receive tips in the amount actually retained by them. 29 C.F.R. § 531.54.

The $30 per month requirement must be satisfied on an individual basis. It is not sufficient that other tipped employees routinely receive more than $30 a month in tips. 29 C.F.R. § 531.56(c). Rather, each employee for whom the tip credit is taken must normally and recurrently receive at least $30 a month. The tip credit is not lost, however, merely because a tipped employee occasionally receives less than $30 a month due to vacation, illness, seasonal fluctuations, or similar circumstances. 29 C.F.R. § 531.57.

B. Employees Must Be Paid a Cash Wage of at Least $2.13 Per Hour

The cash wage requirement is quite simple – the employer must pay tipped employees at least $2.13 per hour for all hours worked. As noted above, an employer may use mandatory service charges to satisfy the cash wage requirement, but the employer may not require or permit employees to turn over any portion of their tips to be used toward the cash wage requirement.

C. Tips Must Make Up the Difference Between Cash Wage and Minimum Wage

It is imperative that employers require employees to accurately report the amount of tips they receive. Employers must be able to establish that each tipped employee's cash wage plus tips equal or exceed the applicable minimum wage rate. In any workweek where tips fail to bridge this gap, the employer must make a supplemental cash wage payment so that the employee receives at least the full minimum wage for all hours worked.

D. Any Overtime Premium Must be Paid in Cash Wages, Not Tips

The FLSA's overtime pay requirement applies to tipped employees, and mandates that tipped employees be paid at least one and one-half times their regular rate of pay for all hours worked in excess of 40 in a workweek. 29 U.S.C. § 207(a)(1). Generally, the regular rate of pay for a tipped employee is the minimum wage rate. *See* 29 C.F.R. § 531.60. According to guidance from the U.S. Department of Labor (DOL), an employer may not take any greater tip credit for overtime hours than it took for non-overtime hours. DOL Field Operations Handbook, § 30d07(a). Thus, for example, if a tipped employee is paid a cash wage of $2.13 per hour, and the employer takes a tip credit of $5.12 per hour to satisfy the $7.25 per hour minimum wage requirement, the employer may take a tip credit of no more than $5.12 per hour for any overtime hours worked. In this scenario, the required cash wage rate for overtime hours is $5.755 ($2.13 "straight time" cash wage plus $3.625 (1/2 of $7.25) overtime premium).

E. Employees Must be Informed of the FLSA's Tip Credit Provision

The statute requires that tipped employees be informed by the employer of the FLSA's tip credit provisions. 29 U.S.C. § 203(m). Courts have generally concluded that, to satisfy this requirement, an employer must inform employees of its intent to take a tip credit toward the employer's minimum wage obligation (i.e., that the employer intends to treat tips as satisfying part of the employer's minimum wage obligation). *See Kilgore v. Outback Steakhouse*, 160 F. 3d 294, 298 (6th Cir. 1998); *Martin v. Tango's Restaurant, Inc.*, 969 F. 2d 1319, 1322 (1st Cir. 1992). "Employers do not have to 'explain' the tip credit to employees, however; it is enough to 'inform' them of it." *Pellon v. Business Representation International, Inc.*, 528 F. Supp. 2d 1306, 1310 (S.D. Fla. 2007), *aff'd*, 291 Fed. Appx. 310 (11th Cir. 2008).

F. Employees Must Retain All Tips, Other Than Those Contributed to Valid Tip Pool

As a general rule, all tips received by tipped employees must be retained by them. 29 U.S.C. § 203(m). If a tipped employee is required to give any tips to the employer, the tip credit is lost in its entirety. For this reason, it is generally the better practice to allow tipped employees to manage their own tip pools, and merely report to the employer the amount of tips each employee has retained.

The FLSA permits *mandatory* tip pooling arrangements among employees who customarily and regularly receive tips. According to DOL guidance, employees who customarily and regularly receive tips include: (1) servers, (2) bellhops, (3) counter personnel who serve customers, (4) bussers, and (5) service bartenders. DOL Field Operations Handbook, § 30d04(a). In addition, hosts, head waiters, and seater/greeters may be eligible to participate in a *mandatory* tip pool if they have sufficient customer interaction. DOL Field Operations Handbook, § 30d07(d); *See Kilgore v.*

Outback Steakhouse, 160 F. 3d 294 (6th Cir. 1998) (finding restaurant hosts to be tipped employees); *Dole v. Continental Cuisine, Inc.*, 751 F. Supp. 799 (E.D. Ark. 1990) (finding a maitre'd to be a tipped employee).

In contrast, DOL has advised that tipped employees may not be *required* to share tips with (1) janitors, (2) dishwashers, (3) chefs/cooks, and (4) laundry room attendants. DOL Field Operations Handbook, § 30d07(c). If tipped employees are *required* to share tips with these types of employees, the tip credit will be lost. Nothing in the FLSA, however, prohibits tipped employees from *voluntarily* sharing tips with any co-workers of their choosing. *Id.* For this reason, many employers choose to permit only voluntary tip sharing arrangements.

Tip pools have been the subject of a number of challenges in court. The challengers typically contend that ineligible employees participated in the tip pool, and/or that the tipped employees' contributions to the tip pool were not truly voluntary. *See, e.g., Roussell v. Brinker International, Inc.*, 2008 WL 2714079 (S.D. Tex. 2008) (considering validity of tip pool that included quality assurance employees (expediters)). Due to the potential loss of the tip credit in its entirety for improper tip pooling, extreme care should be exercised with respect to any tip pooling arrangements.

IV. EMPLOYEES MUST BE ENGAGED IN A TIPPED OCCUPATION

In recent litigation, most notably *Fast v. Applebee's International, Inc.*, 502 F. Supp. 2d 996 (W.D. Mo. 2007), tipped employees have challenged the scope of duties that they were required or permitted to perform while be being paid at a sub-minimum "tipped" wage rate. In particular, tipped employees have argued that the tip credit may be taken only for time spent on tasks that generate tips, and not for time devoted to other, non-tip-producing duties.

In May 2007, the court in *Fast v. Applebee's* ruled that, for purposes of applying the tip credit provision, a tipped employee's duties must be divided, on a task-by-task basis, into three categories: (1) tip producing, (2) incidental to tip producing, and (3) unrelated to tip producing. The court ruled that the tip credit was available for category (1) activities, but that no tip credit could be taken for time devoted to category(3) duties, and that the tip credit could be taken with respect to category (2) only if the time devoted to such work did not exceed 20% of the employee's total working time. The court further ruled that a jury must decide, on a case-by-case basis, how duties are to be assigned to the three categories.

In August 2009, the *Applebee's* court vacated its May 2007 ruling so that the parties could pursue an appeal to the Eighth Circuit Court of Appeals. That process is ongoing, and similar cases remain pending in Illinois and elsewhere. While the litigation remains pending, this issue continues to be unsettled. This article sets forth the authors' view of the relevant, existing legal authorities, but is subject to further clarification by future legal rulings in the pending cases.

A. The Statute Establishes an Occupation-Based Analysis

As noted above, the statute defines "tipped employee" as "any employee engaged in an ***occupation*** in which he customarily and regularly receives more than $30 a month in tips." 29 U.S.C. § 203(t) (emphasis added). In the authors' view, the statute is plain on its face – a tipped employee is an employee engaged in an occupation in which he customarily and regularly receives tips (i.e., a "tipped occupation"), and the minimum cash wage for an employee engaged in a tipped occupation

is $2.13 per hour, as long as tips bring total earnings up to the full minimum wage. Thus, the primary inquiry is whether an employee is engaged in a "tipped occupation."

There are ample, publicly available resources to guide courts in defining the scope of occupations. For example, in a January 2009 opinion letter (FLSA 2009-23 (Jan. 16, 2009)),[2] the DOL's Acting Wage and Hour Administrator concluded that the scope of occupations could be determined by reference to the Occupational Information Network (O*Net), which is sponsored by the DOL's Employment and Training Administration, and is accessible through a link on the DOL's website. (www.doleta.gov/reports/DESA_skill.cfm). According to the O*Net website, "[t]he O*NET program is the nation's primary source of occupational information. Central to the project is the O*NET database, containing information on hundreds of standardized and occupation-specific descriptors. The database, which is available to the public at no cost, is continually updated by surveying a broad range of workers from each occupation." (www.onetcenter.org/overview.html).

The O*Net database is closely linked to the Bureau of Labor Statistics' (BLS) Standard Occupational Classification (SOC) system, which is "used by Federal statistical agencies to classify workers into occupational categories for the purpose of collecting, calculating, or disseminating data." (www.bls.gov/soc).

Sources such as O*Net provide detailed information about occupations, and do so in a manner that is completely neutral. The information provides an accurate picture of occupations generally, independent of the litigation process, and independent of any variations that may be unique to a particular employer. Moreover, sources such as O*Net provide employers and employees a common reference point to determine whether their payroll practices comply with the FLSA. Thus, sources like O*Net, in conjunction with the statute and regulations, provide courts all the information necessary to conduct an occupation-based analysis.

B. DOL's Record-Keeping Regulation Confirms the Occupation-Based Analysis

The FLSA requires employers to maintain payroll records in a manner prescribed by the DOL's Wage and Hour Administrator. 29 U.S.C. § 211(c). Pursuant to this statutory delegation of authority, the DOL promulgated a regulation requiring employers to maintain records of "hours worked each workday in any ***occupation*** in which the employee does not receive tips" and "hours worked each workday in ***occupations*** in which the employee receives tips." 29 C.F.R. § 516.28(a)(4) and (5) (emphasis added). Thus, employers are required (not merely requested or encouraged) to maintain records of hours worked on an occupation basis. The provisions of 29 C.F.R. § 516.28(a)(4) and (5) are consistent with the statute, and dictate an occupation-based analysis.

C. Other DOL Regulations Further Support the Occupation-Based Analysis

In 1967, the DOL published official interpretations of the tip credit provision. These regulations repeatedly emphasize the occupation-based nature of the tip credit inquiry:

[2] As noted below, the January 2009 opinion letter has been withdrawn, and may not be relied upon as a statement of DOL policy.

> The wage credit permitted on account of tips under section 3(m) may be taken only with respect to wage payments made under the Act to those employees whose ***occupations*** in the workweeks for which such payments are made are those of "tipped employees" as defined in section 3(t). Under section 3(t), the ***occupation*** of the employee must be one "in which he customarily and regularly receives more than [$30] a month in tips."

29 C.F.R. § 531.51 (emphasis added).

> If an employee is in an ***occupation*** in which he normally and recurrently receives more than [$30] a month in tips, he will be considered a tipped employee even though occasionally because of sickness, vacation, seasonal fluctuations or the like, he fails to receive more than [$30] in tips in a particular month.

29 C.F.R. § 531.57 (emphasis added).

> An employee who receives tips, within the meaning of the Act, is a "tipped employee" under the definition in section 3(t) when, in the ***occupation*** in which he is engaged, the amounts he receives as tips customarily and regularly total "more than [$30] a month." An employee employed in an ***occupation*** in which the tips he receives meet this minimum standard is a "tipped employee" *for whom the wage credit provided by section 3(m) may be taken in computing the compensation due him under the Act for employment in such* ***occupation***, whether he is employed in it full time or part time.

29 C.F.R. § 531.56(a) (emphasis added).

The regulations quoted above clearly provide that the tip credit may be taken "for employment in such [a tipped] occupation," not merely for performing tasks that generate tips. Perhaps the most clear and complete description of the occupation-based analysis appears in yet another regulation describing a situation in which an employee is engaged in two distinct occupations or, in the DOL's terminology, a "dual job":

> 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, if he customarily and regularly receives at least [$30] a month in tips for his work as a waiter, 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*** of 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***.

29 C.F.R. § 531.56(e) (emphasis added).

Thus, in section 531.56(e), the DOL again emphasized the occupation-based nature of the inquiry and then, to further illustrate the point, expressly stated that "related duties in an occupation that is a tipped occupation need not by themselves be directed toward producing tips." Thus, the regulations unequivocally provide that a task-by-task analysis is not appropriate, and that the only question is whether an employee was engaged in a tipped occupation.

D. Case Law Supports the Occupation-Based Analysis

Despite the fact that the tip credit provision has been part of the FLSA for over 40 years, relatively few courts have been called upon to construe its provisions. One of the most complete analyses of the issue is found in *Pellon v. Business Representation International, Inc.*, 528 F. Supp. 2d 1306 (S.D. Fla. 2007), *aff'd*, 291 Fed. Appx. 310 (11th Cir. 2008). There, skycaps at an airport claimed they should have been paid full minimum wage for performing certain duties they claimed did not produce tips. The court first found that all of the duties at issue fell within the scope of the skycap occupation. The court then reasoned as follows:

> The duties that Plaintiffs have performed in this case are not those of another occupation, even if there is some overlap among tasks between different occupations. They are, at worst, "related duties in an occupation that is a tipped occupation" and they "need not by themselves be directed toward producing tips." 29 C.F.R. 531.56(e); *see also Townsend v. BG-Meridian, Inc.*, No. CIV-04-1162-F, 2005 WL 2978899, at *6-7 (W.D.Okla. 2005) . . . . In *Townsend*, the defendants were entitled to apply [the] tip credit to the entirety of the plaintiff's waitress shifts, not just those hours spent directly serving tables. Because Plaintiff skycaps do not have dual jobs, the same is true here. Plaintiffs do not refute or otherwise distinguish 29 C.F.R. 531.56(e) from their case.

528 F. Supp. 2d at 1313.

The *Pellon* court also considered, and refused to adopt, the task-by-task analysis adopted by the *Applebee's* court:

> Plaintiffs further rely on *Fast v. Applebee's International Inc*. for the proposition that an employee's duties incidental to direct tipped duties may not exceed 20% of their time without the employee being compensated with at least minimum wage for that period of time. 502 F.Supp.2d 996, 1002-03 (W.D.Mo. 2007). However, a determination whether 20% (or any other amount) of a skycap's time is spent on non-tipped duties is infeasible. In fact, several of the plaintiffs themselves have admitted that dividing their workday among the various tasks they perform is impractical or impossible.

> Permitting Plaintiffs to scrutinize every day minute by minute, attempt to differentiate what qualifies as tipped activity and what does not, and adjust their wage accordingly would create an exception that would threaten to swallow every rule governing (and allowing) for tip credit for employers. First of all, ruling in that manner would present a discovery nightmare. Of greater concern is the fact that under the reasoning proffered by Plaintiffs, nearly every person employed in a tipped occupation could claim a cause of action against his employer if the employer did not keep the employee under perpetual surveillance or require them to maintain precise time logs accounting for every minute of their shifts. The threshold issues are also unsolvable: for instance, how far from the curb could Plaintiffs even walk before they are too far to be considered tipped employees for that period?

Id. at 1313-14.[3]

Earlier cases also support an occupation-based analysis. For example, in *Myers v. The Copper Cellar Corp.*, 192 F. 3d 546 (6th Cir. 1999), the restaurant/employer required servers to prepare a house salad for each of their customers. During various peak volume times, however, one server was designated exclusively to prepare house salads for all of the servers then on duty. During such "salad shifts," the salad preparer had no personal contact with diners. *Id*. at 548. The court held that, during "salad shifts," servers were not "tipped employees" "[b]ecause the salad preparers abstained from any direct intercourse with diners, worked entirely outside the view of restaurant patrons, and solely performed duties traditionally classified as food preparation or kitchen support work." *Id*. at 550 (emphasis added). Stated another way, the "salad shift" was a distinct occupation – food preparation – for which no tip credit was available.

Likewise, in *Townsend v. B.G.-Meridian, Inc.*, 2005 WL 2978899 (W.D. Okla. 2005), a server complained that the tip credit should not be applicable to portions of her server shift that she spent operating the cash register and taking phone orders. The court observed:

> The cases that have considered whether a given occupation falls within the definition of a tipped employee have focused on the level of customer interaction involved in that occupation. *See Kilgore v. Outback Steakhouse of Florida, Inc.*, 160 F.3d 294 (6th Cir. 1998); *Myers v. The Copper Cellar Corporation*, 192 F.3d 546 (6th Cir. 1999). Customer service positions in which the employee has more than de minimis interaction with customers have been found to be tipped occupations even where the employees are prohibited from accepting tips directly from customers. *See Kilgore*, 160 F.3d at 306 (finding restaurant hosts to be tipped employees); *Dole v. Continental Cuisine, Inc.*, 751 F. Supp. 799 (E.D. Ark. 1990) (finding a maitre'd

[3] In *Ash v. Sambodromo, LLC*, 2009 WL 3856367 (S.D. Fla. Nov. 17, 2009), a magistrate judge in the Southern District of Florida (where *Pellon* was decided) adopted the *Applebee's* court's three-category analysis, despite the fact that the *Applebee's* decision had been vacated two months earlier, and despite the fact that *Pellon* had rejected the *Applebee's* decision two years earlier.

> to be a tipped employee). On the other hand, employees who are cut off from all customer contact have been found to fall outside the definition of tipped employees. *See Elkins v. Showcase, Inc.*, 237 Kan. 720, 704 P.2d 977, 989 (Kan. 1985); *Myers*, 192 F.3d 546. Certainly [plaintiff], when operating the cash register and taking telephone orders, had more than de minimis customer contact. In fact, she concedes that all duties assigned her involved customer service. . . . Thus all her positions fell within the definition of "tipped employee" as set out in 203(t). . . . Pursuant to 29 C.F.R. 531.56, a tipped employee's status does not change simply because she is called upon to perform non-tipped duties related to her job.

Id. at *6-7 (emphasis added). *See also Hodgson v. Frisch's Dixie, Inc.*, 1971 WL 837 (W.D. Ky. 1971) (holding that tip credit was not available for instances in which "waitresses and carhops were frequently required to work in 'non-tipped' occupations for substantial periods of time during their shifts."). These cases further support the conclusion that the tip credit provision is governed by an occupation-based analysis.

E. Other Informal DOL Guidance is Inconsistent and Unpersuasive

In addition to the regulations and rulemaking discussed above, the DOL has spoken on the tip credit issue through informal means – in particular, by way of opinion letters and an agency manual. The Supreme Court has cautioned courts to carefully consider such informal guidance. *Christensen v. Harris County*, 529 U.S. 576, 587 (2000). "Reviewing courts must also be careful not to allow an agency to create de facto new regulations under the guise of interpreting an earlier regulation." *Glover v. Standard Federal Bank*, 283 F. 3d 953, 959 n. 4 (8th Cir. 2002).

Over the years, the DOL's Wage and Hour Administrator has had several occasions to discuss the tip credit provision in opinion letters. For example, in 1969, the DOL was asked to clarify when the tip credit could be taken with respect to taxi drivers who also worked as dispatchers and supervisors. The Administrator advised:

> It is our opinion that the activities of driving and dispatching and/or supervising are unrelated for the purposes of section 531.56(e) of Part 531, so that the subject employees may be regarded as being employed in dual jobs. Therefore, if the employee customarily and regularly receives at least $20 a month in tips for his work as a taxicab driver, he is a tipped employee only with respect to his employment as a taxicab driver. Since he is employed in two occupations, no tip credit can be taken for his hours of employment in his occupation of dispatcher and/or supervisor.

DOL Opinion Letter No. 981 (April 16, 1969).

In 1980, the DOL was asked to consider the tip credit in a restaurant setting. The Deputy Administrator discussed the issue as follows:

> You state the tipped employees clean the salad bar, place the condiment crocks in the cooler, clean and stock the waitress station, clean and reset the tables (including filling cheese, salt and pepper shakers) and vacuum the dining room carpet, after the restaurant is closed. . . .
>
> As you know, section 531.56(e) of 29 CFR Part 531, deals with tipped employees who are performing dual jobs. This section explains that a waitress who spends part of her time cleaning and setting tables, toasting bread, making coffee and occasionally washing dishes or glasses is not employed in two occupations. Further, such related duties in an occupation that is a tipped occupation need not by themselves be directed toward producing tips. As indicated, however, where there is a clear dividing line between the types of duties performed by a tipped employee, such as between maintenance duties and waitress duties, no tip credit may be taken for the time spent by a waitress performing maintenance duties.
>
> Insofar as the after-hours clean-up you describe are [sic] assigned generally to the waitress/waiter staff, we believe that such duties constitute tipped employment within the meaning of the regulation.

DOL Opinion Letter WH-502, 1980 WL 141336 (March 28, 1980).

These two opinion letters are consistent with the occupation-based analysis in the statute and regulations, and therefore are entitled to judicial respect. *See Christensen*, 529 U.S. at 587. Informal DOL guidance that is not consistent with the statute and regulations, however, is not entitled to judicial respect.

In 1988, the DOL added a section related to tipped employees to its Field Operations Handbook ("FOH" or "Handbook"). According to the DOL website where the Handbook can be found, the Handbook is

> an operations manual that provides Wage and Hour Division (WHD) investigators and staff with interpretations of statutory provisions, procedures for conducting investigations, and general administrative guidance. . . . The FOH reflects policies established through changes in legislation, regulations, court decisions, and the decisions and opinions of the WHD Administrator. Further, *the FOH is not used as a device for establishing interpretative policy*.
>
> The Department of Labor (DOL) is providing the information in this handbook as a public service. This information and other related materials are presented to provide public access to information regarding DOL programs. . . . *The Federal Register and the Code of Federal Regulations remain the official resources for regulatory information published by the DOL*.

www.dol.gov/esa/whd/FOH/index.htm (emphasis added).

The DOL's own description of the Handbook indicates it is not to be used as a device for establishing interpretative policy. Yet that is precisely what happened in the *Applebee's* litigation. Plaintiffs cited Handbook section 30d00(e) as support for their contention that a tipped employee's occupation must be broken down into its component duties, and each duty separately analyzed to determine whether it is tip producing. As discussed above, such an approach is in direct conflict with the statute and regulations.

Handbook section 30d00(e) begins, appropriately enough, with reference to 29 C.F.R. § 531.56(e), which provides that duties related to a tipped occupation need not themselves be directly tip producing. The Handbook apparently refers to these "non-tip producing" duties as "maintenance and preparatory or closing duties." The Handbook then departs from the statute and regulations, however, by apparently seeking to impose an arbitrary 20% cap on such duties.

There is no basis in the statute or regulations for the proposition that the tip credit is subject to a 20% limit on some of the duties that make up the tipped occupation. To construe the Handbook in that way would impermissibly create a de facto new regulation under the guise of interpreting an earlier regulation. *See Glover*, 283 F. 3d at 959 n. 4 (8th Cir. 2002). Accordingly, the 20% cap in section 30d00(e) has no persuasive value and should be rejected.

This conclusion is underscored by the fact that Congress has clearly spoken on the issue. The statute requires that tipped employees receive no less than the full minimum wage through a combination of their cash wage and the tips they receive. This statutory limitation requires a tipped employee's work to be sufficiently tip-producing to ensure that the employee receives the full minimum wage. But it requires nothing more. Because Congress has established the quantitative limit for application of the tip credit, the DOL Handbook should not be interpreted to create an additional quantitative limit that has no basis in, and is at odds with, the statute.

On this point, the Sixth Circuit's analysis in *Kilgore v. Outback Steakhouse*, 160 F. 3d 294 (6th Cir. 1998), is particularly relevant. There, plaintiffs (servers and hosts in a restaurant) claimed Outback owed them the full minimum wage because Outback allegedly maintained an improper tip pooling arrangement. They challenged the tip pooling arrangement on several bases, including that it allegedly required employees to "tip out" (i.e., give) an unreasonable percentage of their tips to other employees. In support of their argument, the plaintiffs relied on two DOL opinion letters stating that tipped employees could only be required to tip out a "reasonable and customary" amount, which the opinion letters defined as no more than 15% of tips. Although the *Kilgore* case referred only to the two opinion letters, the same 15% limit appears in the DOL Handbook at section 30d04(b).

The Sixth Circuit refused to engraft a 15% limit into the statute, holding:

> The opinion letters provide no reasoning or statutory analysis to support their conclusion that there is a "reasonableness" limit on how much an employer can require an employee to tip out. . . . [N]othing in the language of [29 U.S.C. § 203(m)] appears to support this limitation. Subsection 203(m) neither limits the amount of a tip out to what is "customary and reasonable" nor states that a tip out should not exceed 15% of an employee's tips.

160 F. 3d at 303.

In rejecting the DOL's 15% limit on tip outs, the Sixth Circuit observed that an employer's power to require tip outs is limited by the statute itself: "the requirement of a minimum wage does limit how much an employer can require a server to tip out. For example, Outback could not require a server to tip out such a high percent of tips that the server no longer received the minimum wage." *Id*. at 303, n. 7. The Sixth Circuit's analysis of this similar issue is compelling – the Handbook cannot be interpreted to create an entirely new quantitative limit on the mix of duties that make up a tipped occupation.

The DOL itself has questioned Handbook section 30d00(e). In January 2009, the Acting Wage and Hour Administrator issued an opinion letter directly addressing the issue at hand. *See* FLSA 2009-23 (Jan. 16, 2009). The opinion letter was subsequently withdrawn, and thus cannot be relied upon as a statement of DOL policy. Nonetheless, the opinion letter contains a thorough, well-reasoned analysis of this issue. In particular, the opinion letter noted the confusion and inconsistent judicial rulings the Handbook has spawned, and recognized the need for clarity so that employers may take the steps necessary to comply with the FLSA. The opinion letter concluded that the statute and regulations call for an occupation-based analysis, and that Handbook section 30d00(e) is in need of revision to bring it into compliance with the law. Even though the 2009 opinion letter does not presently constitute a statement of DOL policy, it nonetheless presents a persuasive discussion of the applicable legal standard, and fully supports an occupation-based analysis.

Another DOL opinion letter and one judicial decision merit brief additional discussion. In opinion letter FLSA-854 (Dec. 20, 1985), the DOL considered whether the tip credit was available with respect to a server's pre-opening duties, an issue similar to the post-closing duties addressed in the DOL's 1980 opinion letter (discussed above). In 1985, however, the DOL was troubled by the fact that the server spent nearly half of her shift preparing the restaurant for business before the restaurant opened. The server reported for work 1.5 to 2 hours before the restaurant opened, and worked a 5 hour shift. Although the server performed several tasks that had been identified in previous DOL guidance as falling within the tipped occupation (such as setting tables, stocking waitress stations, filling shakers, and preparing coffee), the DOL concluded that no tip credit could be taken for the time spent before the restaurant opened.

A federal district court addressed a somewhat similar situation in *Dole v. Bishop*, 740 F. Supp. 1221 (S.D. Miss. 1990). There, the court found that "waitresses spent a substantial portion of their time [2 to 4 hours] in the afternoons before the restaurant opened performing such duties as cleaning bathrooms and other general areas of the restaurant, chopping vegetables, and making puddings and ice cream. Because these cleaning and food preparation duties were not incidental to the waitresses' tipped duties, the waitresses were entitled to the full statutory minimum wage during these periods of time." *Id*. at 1228.

In other words, the *Bishop* court found that, where pre-open time is spent exclusively on food preparation and general cleaning, and where the time spent is 2 to 4 hours per shift, it should be deemed to be outside the scope of the server occupation. Similarly, the 1985 opinion letter concluded that, where an employee devotes exclusive attention to preparing the entire restaurant for business before the restaurant opens, and the time spent on such activities is 30 to 40% of the shift, such duties should be deemed to be outside the tipped occupation.

The 1985 opinion letter and the *Bishop* court grappled with one of the realities of the workplace – the duties that make up occupations are not mutually exclusive. Servers in restaurants perform some duties, such as food preparation and cleaning, that may also be performed by employees in other occupations. The fact that a server performs some duties that may be performed by employees in other occupations does not make those duties any less a part of the server occupation. But the 1985 opinion letter and the *Bishop* case would impose a limit on duties like cleaning and food preparation when they are performed for significant blocks of time when the restaurant is not open for business.

As discussed above, the statute itself already limits the extent of pre-open and post-close duties through the mandate that tipped employees receive minimum wage in cash wages and tips combined. Accordingly, even if a court were to determine (based on *Bishop* and/or the 1985 opinion letter) that there should be a temporal limit on certain duties performed when the restaurant is not open for business, any such limit should be consistent with the statutory framework that dictates an occupation-based analysis. In other words, there should be a determination that pre-open or post-closing duties are so distant from the server occupation that the time spent pre-open or post-close should be deemed to be work in a distinct occupation. Further, even if a court were to reach such a conclusion regarding pre-open and post-closing time, there would continue to be no support for any sort of task-by-task analysis of server duties over the course of an entire shift.

Unfortunately, the issues raised in *Applebee's* and other cases remain unsettled. Employers must await further clarification from the courts before any definitive conclusions may be drawn.

V. COMPLIANCE SUGGESTIONS

The statutory requirements discussed in section III above are plain and, although strict compliance is necessary, compliance is relatively straight-forward. In review,

> (1) employees must be engaged in an occupation in which they customarily and regularly receive more than $30 a month in tips;
>
> (2) employees must be paid a cash wage of at least $2.13 per hour;
>
> (3) tips received by employees must make up the difference between the cash wage and the minimum wage;
>
> (4) tips may not be used to satisfy the overtime premium requirement;
>
> (5) the employer must inform employees of the FLSA's tip credit provision; and
>
> (6) employees must retain all tips, other than those contributed to a valid tip pool.

The scope of permissible duties discussed in section IV, however, is more problematic, at least until courts provide greater clarity. For now, employers should strive to have tipped employees focus on duties that are closely linked to guest service. Managers should monitor tipped employee activities, and redirect tipped employees who spend significant time performing duties such as food preparation or dishwashing. Employers also may wish to consider payment of full minimum wage for hours worked by tipped employees when the establishment is not open for business or when guests are no longer at the establishment.