

IMPROPER TIP POOLING

TARGETED IN CLASS ACTION LAWSUITS

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The use of class action lawsuits against large corporations over allegedly illegal tip pooling arrangements is increasingly common. This work examines the use of class action lawsuits for this type of lawsuit and analyzes two recent cases from Massachusetts and New York targeting the legality of Starbucks' tip pooling policy under the laws of each state respectively. Both cases represent significant developments in this area of law in that each, for the first time, provides court interpretations of their respective state statutes regulating tip pooling arrangements. In light of the specific requirements of Massachusetts law, the Massachusetts case yielded a \$23.5 million settlement with Starbucks. In contrast, under the different requirements of New York law, Starbucks won a significant victory on certain aspects of the case while other aspects remain unresolved. These cases represent but examples of the difficulties even large corporations encounter in complying with the vast array of applicable federal and state laws affecting their operations.

In 2006, Nation's Restaurant News described tip pooling lawsuits as "this year's 'in vogue' class-action claim in California" (Jennings, 2006, p. 3). Fast forward to 2013 and it is clear that California is far from alone. Recent decisions from courts in Massachusetts and New York resolve the interpretation of previously untested language in their respective state statutes regulating tip pooling. Both cases involved class action lawsuits targeting Starbucks' corporate policies regarding which employees are eligible to participate in the pool of accumulated tips. Indeed, the nationwide level of class action lawsuits over improper tip pooling arrangements is so high it is identified as a "key area to watch" in the 2013 Edition of the Annual Workplace Class Action Litigation Report (Maatman, 2013, p.8). Before examining the new developments resulting from the Massachusetts and New York cases, it is important to understand the broader context in which tipping occurs along with its regulatory environment and the reasons underlying the use of class action lawsuits against employers for alleged violations.

Broader Context of Tipping

The practice of tipping dates to 18th century England with its roots in the United States traced to post Civil War European travel by "wealthy Americans" who returned from their trips abroad continuing to tip here as a way to "flaunt their worldliness" (McConnell, 2009, pgs. 622-623). In modern times, rather than being a cultural indicator of worldliness, tipping has taken on a measure of "economic significance" (Azar & Tobol, 2008, p. 246.). On an annual basis, tips paid in the U.S. food service industry are estimated to be approximately \$44 billion with millions of

employees earning a significant portion of their income in the form of tips (Azar & Tobol, 2008, p. 246).

Regulatory Environment

With tips taking on a greater importance as part of employee income, it is not surprising that tip related issues became subject to both federal and state regulations. On the federal level, this occurred in 1966 when Congress did two things. First, it included restaurant workers in the group of employees protected under the Fair Labor Standards Act (FLSA) which, among other things, establishes minimum wage rates. Second and more directly germane to modern lawsuits over improper tip pooling:

...Congress adopted the concept of a tip credit which allowed employers to credit an employee's tips to satisfy the federal minimum wage requirement. Along with the tip credit, Congress adopted the practice of tip pooling among customarily and regularly tipped employees which allowed employees to pool their tips together. Tip pooling was a method of ensuring fairer distribution of tips and promoting harmony among employees (McConnell, p. 623).

These new regulations negatively impacted employers by drawing more of their employees under the coverage of the federal minimum wage. However, this was mitigated by the tip credit provisions which permitted them to use tips paid to employees as an offset to meeting the required minimum hourly wage. Tip pooling facilitated the sharing of tips among all eligible employees which minimized the likelihood some tipped employees might not, of their own accord, earn enough in tips to reach the required minimum wage. This was of concern to employers because under the FLSA, employers must make up the difference when individual employee's hourly wage (\$2.13/hour) plus tips does not add up to the required minimum wage of \$7.25/hour ("Fact Sheet #15: Tipped Employees Under the Fair Labor Standards Act (FLSA)," 2011).

Like many other areas of law, in addition to the federal requirements, states also regulate tip related issues. Consequently, businesses employing customarily tipped employees must comply with both the federal law as well as the laws of the state or states in which they operate. As a result, for example, if a state has a minimum wage rate higher than that set by the federal government; employers in that state must meet the higher state rate. Further, while many state laws regulating tips follow the model of the federal law by allowing employers to utilize a tip credit to meet the minimum hourly wage, some do not. The states that do not allow an employer to use a tip credit to satisfy the minimum wage include: Alaska, California, Minnesota, Montana, Nevada, Oregon, and Washington (McConnell, 2009, p. 638).

Tip Pool: The requirement that an employee must retain all tips does not preclude a valid tip pooling or sharing arrangement among employees who customarily and regularly receive tips, such as waiters, waitresses, bellhops, counter personnel (who serve customers), bussers, and service bartenders. A valid tip pool may not include employees who do not customarily and regularly receive tips such as dishwashers, cooks, chefs, and janitors ("Fact Sheet #15: Tipped Employees Under the Fair Labor Standards Act (FLSA)," 2011).

While the FLSA is silent on the question of whether or not an employer can require tipped employees to share tips with other employees, some state laws permit such employer mandates while others only permit tip pooling arrangements voluntarily adopted by affected employees (McConnell, 2009). Though silent on mandatory versus voluntary tip pooling, the federal law is not silent on who may share in a lawfully established pool. As indicated above, only those employees who “customarily and regularly receive tips” can participate. Again, many state laws use different criteria for determining who is and is not eligible to receive tips from a tip pooling arrangement (McConnell, 2009). Other areas in which state laws differ from one another include those which address how tipped employees are notified that the employer is utilizing a tip credit system and whether “service fees” are treated as tips to be paid out to employees or simply additional revenue to be retained by the business.

Why Class Action Lawsuits?

At this point in time, class action lawsuits are the preferred method being used by the parties bringing these lawsuits over purportedly illegal tip pooling arrangements. In many respects, class action lawsuits are designed for precisely this kind of situation. A class action lawsuit is one in which a single individual or small group of individuals brings a lawsuit on behalf of a larger group all of whom allegedly suffered the same legal wrong. In many instances, the alleged violations involve small damages to any one plaintiff but are significant when added together for all group members. Consequently, permitting such cases to proceed on behalf of the larger group permits a wrong (if there is one) to be remedied when a single individual pursuing such a claim would be impractical. For example, consider a hypothetical in which a wireless phone company systematically overcharges each of its customers by \$1.00 per month. Even if they are aware of it, few customers possess access to the financial resources to mount a lawsuit for the purposes of recovering such a paltry amount. However, when that \$1.00 per month overcharge is multiplied by the total number of customers over a period of years, it represents substantial revenue to the company. Such situations represent the classic type of scenario envisioned for class action lawsuits. Individual tipped employees are in a similar situation in that the damage to any single employee is small while the overall impact can be significant.

Federal law permits class actions in civil lawsuits under certain limited circumstances. For a lawsuit to proceed as a class action, it first must be certified by a judge as meeting the applicable criteria. That is, a judge has to approve a lawsuit as a class action lawsuit for it to proceed as such. The general rules laying out the criteria for class certification are found in Rule 23(a) of the Federal Rules of Civil Procedure:

Prerequisites: One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class (Federal Rules of Civil Procedure).

In the Massachusetts class action lawsuit, the basic question before the court was whether Starbucks' tip pooling policy violated applicable state law by permitting shift supervisors to share in the tip pool that, allegedly, should have been limited to baristas. Consequently, under Rule 23(a), the court certified as a class "[a]ll individuals who were employed as baristas at any Starbucks store located in the Commonwealth of Massachusetts at any time between March 25, 2005, and [March 18, 2011] inclusive" (Matamoros v. Starbucks Corp., 2012, p. 17). Similarly, the New York case against Starbucks involves which categories of employees are eligible to participate in the tip pool in light of New York's tip pooling statute. However, the New York case raises the question not only in regard to baristas and shift supervisors but also assistant store managers. In New York what began as two separate cases was consolidated by the court into a single case because of the common questions raised in each (Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp. 2012).

It is not hard to see how these cases readily lend themselves to meeting the criteria for class certification. They involve large numbers of people – all employees who hold certain job titles during the relevant period of time (Rule 23(a)(1)). The legal and factual questions are essentially the same – employees were subject to the same tip pooling policy and those holding certain titles shared in the tip pool while others did not (Rule 23(a)(2)). The claims and defenses of the named parties who brought the lawsuit are essentially the same as those of other members of the class – all employees holding the same job title were treated the same (Rule 23(a)(3)). And finally, the named parties are in a position to adequately represent the interests of other members of the class (Rule 23(a)(4)). Among other things, this last criteria is established by virtue of the parties showing they have access to the necessary and appropriate resources to adequately pursue the case. This turns in part on the lawyers who are representing the class. As noted by Maatman in the 2013 Edition of the Annual Workplace Class Action Litigation Report : “A certitude of the modern American workplace is that class action litigation ... is a magnet that attracts skilled members of the plaintiff's bar” (Maatman, 2013, p. 7). Indeed, some lawyers have developed a specialty in bringing class action tip related lawsuits. For example, Shannon Liss-Riordan and Hillary Schwab who are involved in both the Massachusetts and New York cases against Starbucks describe themselves as “pioneering ... the law protecting tipped employees” touting “more than fifty court-approved class action settlements” for tip law violations (Lichten & Liss-Riordan, P.C.: The Labor, Employment & Class Action Specialists, 2011). It is worth noting that this is only two lawyers from one Boston law firm.

New Developments: Massachusetts Class Action Tip Pooling Ruling

The first Massachusetts case against Starbucks was filed in 2008 (Qualters, 2012). The lawsuit challenged Starbucks' policy regarding which categories of employees are eligible to participate in the tip pool. The lawsuit alleged that in violation of Massachusetts state law, Starbucks' corporate policy permitted ineligible employees to share in the tip pool. Specifically, the lawsuit claims that under Massachusetts law, the only Starbucks' employees eligible to participate in a store's tip pool are baristas. In resolving this question, as noted by Judge Selya in the court's decision, this case “presents an unsettled question as to the meaning of the current version of the [Massachusetts] Tip Act” (Matamoros v. Starbucks Corp., 2012, p. 5) (emphasis added).

In 2004, the legislature amended the Massachusetts Tip Act and it is this new and amended version at issue in the lawsuit against Starbucks. The relevant portions of the amended statute in dispute include the following.

No employer or person shall cause, require or permit any wait staff employee service employee, or service bartender to participate in a tip pool through which such employee remits any wage, tip or service charge, or any portion thereof, for distribution to any person who is not a wait staff employee, service employee, or service bartender. An employer may administer a valid tip pool and may keep a record of the amounts received for bookkeeping or tax reporting purposes (Massachusetts Tip Act, §152A(c) 2013).

In short, this provision of the Massachusetts Tip Act allows employers to require employees to participate in a tip pooling arrangement. However, this is permitted only within certain limitations. One of those limitations is that “wait staff” employees shall not be required to share tips with anyone who is not a “wait staff employee” (Matamoros v. Starbucks Corp., 2012, p. 6). The legal definition of “wait staff employees” is found in another section of the Massachusetts Tip Act.

“Wait staff employee”, a person, including a waiter, waitress, bus person, and counter staff, who: (1) serves beverages or prepared food directly to patrons, or who clears patrons’ tables; (2) works in a restaurant, banquet facility, or other place where prepared food or beverages are served; and (3) who has no managerial responsibility (Massachusetts Tip Act, §152A(a) 2013).

The court’s decision in this case turned on its interpretation of which categories of Starbucks’ employees qualified as “wait staff” within the meaning of that term as defined by Massachusetts law.

As described by Judge Selya, Starbucks outlets operate with four categories of employees: store managers, assistant managers, shift supervisors and baristas. The primary focus of this case involved baristas and shift supervisors. Per company policy, both categories of employees shared in the tip pool at each Massachusetts Starbucks store. Judge Selya noted that while both baristas and shift supervisors directly waited on customers; baristas were the “front- line employees” while “shift supervisors perform those functions and other functions as well” (Matamoros v. Starbucks Corp., 2012, p. 3). While it is easy to see that both baristas and shift supervisors meet the definition of “wait staff” in accordance with the first two criteria (they directly wait on customers in a business that serves food and beverages) of the Massachusetts Tip Act provisions, it is not clear whether the “other functions” performed by shift supervisors are managerial responsibilities that render them ineligible under the third criterion.

In defending the legality of including shift supervisors in their tip pooling policy, Starbucks pointed out that shift supervisors spend “up to ninety percent” of their time doing the same work as baristas (Matamoros v. Starbucks Corp., 2012, p. 7). Further, while conceding that shift

supervisors indeed perform “limited supervisory tasks,” Starbucks argued that these tasks are insufficient to qualify as “managerial responsibility” (*Matamoros v. Starbucks Corp.*, 2012, p. 7). In evaluating these claims, the court examined the nature of these additional tasks. As described by the court:

... a shift supervisor is charged with opening and closing the store, handling and accounting for cash, and ensuring that baristas take their scheduled breaks. Indeed, whenever there is no store manager or assistant manager on duty in a particular emporium, the shift supervisor is the ranking employee in the store. In this capacity, the shift manager is responsible for deploying baristas to their work stations, opening the store’s safe, and handling cash register tills. ... Starbucks’ internal documentation is even more revealing; its written job description for the position explains that each shift supervisor “directly manage[s]” three to six other employees while on shift. Shift supervisors’ specific responsibilities include “direct[ing] partners to various workstations” and “providing ... coaching and feedback” (*Matamoros v. Starbucks Corp.*, 2012, pgs.12-13).

The court had little difficulty concluding that though limited in scope, these kinds of responsibilities nevertheless qualify as managerial in nature. Coupling this with the unambiguous language of the third criterion in the statute which defines wait staff as employees possessing “no managerial responsibility” (emphasis added), the court readily declared that “in this case, all roads lead to Rome;” in Massachusetts, Starbucks’ “shift supervisors are not ‘wait staff’ within the meaning of the Tips Act” (*Matamoros v. Starbucks Corp.*, 2012, p. 16).

As a result of this ruling by the United States Court of Appeals for the First Circuit, the district court’s finding that Starbucks owed Massachusetts based baristas approximately \$14 million (before interest) was upheld (*Matamoros v. Starbucks Corp.* 2013, p. 3). Nevertheless, that is not the end of the case. This first Massachusetts case against Starbucks covered the period of time from March 25, 2005 to March 18, 2011 (*Matamoros v. Starbucks Corp.*, 2012, p. 5). Consequently that \$14 million does not address baristas who were illegally required to share tips with shift supervisors after March 2011. While the first case made its way through the courts, Starbucks continued to operate with a tip pooling policy permitting shift supervisors to share in the pool. To address the continuing improper tip pooling arrangement, the same lawyers who brought the first case, filed a second tip pooling case against Starbucks in Massachusetts – *Black v. Starbucks Corp.* (2012). At this point, both cases have been consolidated into a single class action settlement which calls for Starbucks to pay \$23.5 million plus the costs of administration to settle both cases (*Matamoros v. Starbucks Corp.* 2013, p. 2).

New Developments: New York Class Action Tip Pooling Ruling

In New York, what began as two separate cases were consolidated into a single case for the purposes of proceeding to trial (*Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp.* 2012). The general question raised in New York is the same question raised in Massachusetts: which categories of employees are entitled to share in the tip pooling arrangement? Nevertheless, the specifics of the New York case are different in two respects.

First, the applicable New York statute is different from that in Massachusetts. Second, the New York case not only raises the question of whether both baristas and shift supervisors are eligible to share in the tip pooling arrangement; it challenges Starbucks' policy of excluding assistant store managers from participating in the tip pool.

Under New York law, the state law defining who is and is not eligible to share tips was adopted in 1968 and reads as follows:

No employer or his agent or an officer or agent of any corporation, or any other person shall demand or accept, directly or indirectly, any part of the gratuities, received by an employee, or retain any part of a gratuity or of any charge purported to be a gratuity for an employee Nothing in this subdivision shall be construed as affecting the ... sharing of tips by a waiter with a busboy or similar employee (New York Labor Law, §196-d, 2013).

The crux of this case revolves around the interpretation of which Starbucks' employees are "agents" of the corporation. As spelled out in the statute, an "agent" of the employer is not eligible to share tips while a "busboy" or "similar employee" is eligible to participate in a tip pooling arrangement. In the portion of this case dealing with baristas and shift supervisors, the baristas argue "that any supervisory responsibility, however slight, renders an employee (such as a shift supervisor) an agent, and therefore, ineligible to participate in a tip pool" (Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp. 2013, p. 8). On the other side of this argument are the assistant store managers who want to be included in the tip pool. They argue for their inclusion by "contending that only employees with 'full' managerial authority – i.e., the ability to hire and fire subordinates – should be viewed as agents and, as a result, assistant store managers remain eligible for tip distribution" (Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp. 2013, p. 8). Starbucks takes a middle position. In defense of its tip pooling policy, Starbucks argues that shift supervisors are sufficiently similar to waiters that they should be permitted to share in the tip pool while the "significant managerial" responsibilities of assistant store managers should render them ineligible as "agents" of the company (Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp. 2013, p. 8).

To resolve the proper interpretation of the statutory language relative to the baristas, the court turned to guidance from the New York Department of Labor (DOL). In doing so, the court observed that "the DOL has consistently, and in our view, reasonably, maintained that employees who regularly provide direct service to patrons remain tip-pool eligible even if they exercise a limited degree of supervisory responsibility" (Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp. 2013, p. 8). Consequently, the court concluded that shift supervisors are not "agents" of Starbucks and thereby are eligible to share in the tip pooling arrangement.

For the assistant store managers, the court had to determine whether (as the assistant store managers argued) only employees with the authority to hire and fire subordinates qualify as "agents" of the employer. In the end, the court rejected this proposed litmus test. As the court explained:

We conclude that the line should be drawn at meaningful or significant authority or control over subordinates. Meaningful authority might include the ability to discipline subordinates, assist in performance evaluations or participate in the process of hiring or terminating employees, as well as having input in the creation of employee work schedules, thereby directly influencing the number and timing of hours worked by staff as well as their compensation (*Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp.* 2013, p. 13-14).

Having established the legally appropriate standard, the appeals court returned the question of whether assistant store managers possessed such “meaningful authority” to the trial court for it to determine.

This left one remaining question in this case. Does the applicable New York law require employers to include in their tip pooling arrangement all employees who are eligible to participate? On this point, the New York Court of Appeals agreed with the lower court’s conclusion that while the New York law excludes some employees from being eligible for inclusion in a tip pooling arrangement, the language of the statute does not require the inclusion of all employees who meet the eligibility criteria (*Barenboim v. Starbucks Corp. & Winans v. Starbucks Corp.* 2013, p. 15).

Conclusion

In some ways, the most significant point to be drawn from all of this is that between 2006 and 2013, class action lawsuits over improper tip pooling shifted from being the “in vogue class action claim in California” (Jennings, 2006, p. 3) to a “key area to watch” according to the Annual Workplace Class Action Litigation Report (Maatman, 2013, p.8). Within the larger context, the Massachusetts and New York cases are simply part of what the Annual Workplace Class Action Litigation Report describes as a “deluge” of class action wage and hour lawsuits against corporations in the United States with “no end in sight” (Maatman, 2013, p.8). This will continue to present a challenge to corporations whose employees receive part of their compensation in the form of tips – particularly when such employees are subject to an employer established tip pooling arrangement.

This leads to the second significant point. While violations of tip sharing requirements may be too small for any individual employee to pursue, when filed as class action lawsuits, seemingly small cases not only can but sometimes do turn into multi-million dollar losses.

Third, with the Massachusetts ruling, for the first time, Massachusetts businesses have a detailed interpretation from the courts concerning the meaning and application of the Massachusetts Tip Act. This important development coupled with the court’s endorsement of the unambiguous criteria to be applied forewarns businesses of the need to be particularly vigilant in complying with the law and remaining current with any changes. In all likelihood, more class action lawsuits over improper tip pooling will be brought against other Massachusetts corporations with

tipped employees. It is difficult to imagine that Starbucks is the only larger employer in the state that failed to adjust its tip pooling policy when Massachusetts amended its state law in 2004.

Similarly, the New York case is significant in that it, for the first time, provided a court's interpretation of certain aspects of New York's tip sharing laws. In the New York cases, Starbucks prevailed by successfully defending the inclusion of shift supervisors in its tip pooling arrangement under the requirements of New York law. At the same time, the portion of that case involving assistant store managers remains to be resolved leaving ambiguity in that dimension of New York's tip sharing law.

Finally, these case examples highlight the difficulty and complexity even a large corporation such as Starbucks encounters when complying with the myriad of both state and federal laws affecting its operations. At the same time, it goes without saying that it is their very size and perceived resources (i.e. deep pockets) that makes them ready targets for the kind of lawsuits examined here.