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Tip Pooling: A New Wage and Hour Issue to Be Exploited?

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Maybe like your morning, the controversy over tip pooling perked up over a cup of coffee. A little over a year ago, a court awarded over \$85 million dollars to Starbucks “baristas,” finding a Starbucks tip pooling policy allowed shift supervisors to unlawfully share in the pooled tips. While many employers may be familiar with other wage and hour issues, such as overtime and meal and rest breaks, tip pooling is one of those issues that has gone undisturbed for many years. Now that the sleeping giant is awake, employers in applicable industries should become fully aware of the current rules in California governing tip pooling.

What is “Tip Pooling”?

Tip pooling is most common in the hospitality industry and others in which employees work for gratuities. In many businesses, tips are combined or “pooled,” for the employer to later distribute to the employees based on a formula that varies from establishment to establishment.

Pooling permits employees to provide good service while at the same time eliminating friction or quarreling between employees over tips, “good” v. “bad” table assignments, etc. Pooling also allows the employer to distribute a portion of the tips to employees who contribute to the service experience, but who may not directly receive gratuities from the customer.

The Court of Appeal upheld the concept of tip pooling in Leighton v. Old Heidelberg, Ltd. The issue in that case was whether California Labor Code section 351, which prescribes that tips are the sole property of employees, barred employers from instituting mandatory tip pooling policies. In short, the Court said “no,” thus formally recognizing what had already been an industry standard.

Tip Pool Participants

California Labor Code section 351 affirmatively prohibits employers and their agents from participating in tip pooling. Specifically, they may not take, receive, share in, or deduct tips from an employee’s pay.

For purposes of tip pooling, an “employer” is “any person who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours or working conditions of any person.” An “agent” is “every person other than the employer having the authority to hire or discharge any employee or supervise, direct, or control the acts of employees.”

Supervisors and managers who hire, fire, discipline, assign work, set wages, schedules shifts, etc. are “agents” and cannot participate in tip pooling. This is true even if they spend time performing non-supervisory/managerial duties. In the Starbucks case, Starbucks attempted to argue “shift supervisors” spent most of their time

providing customer service to patrons rather than “supervising.” The Court nevertheless ruled that their participation in the tip pool was unlawful.

This issue of who constitutes a supervisor/manager most recently came under scrutiny in the casino industry. In Lu v. Hawaiian Gardens Casino, Inc., the casino’s tip pooling policy allowed certain “customer service representatives” who had previously been called “shift supervisors” to receive pooled tips. The California Court of Appeal found a disputed issue of fact as to whether these employees were “agents.” These employees evaluated the conduct of casino dealers and other employees, responded to patron complaints about dealers, and criticized and directed dealers on their conduct at work. In some circumstances, a “customer service representative” would be in charge of a section of the casino during his or her shift and have the authority to allow an employee to leave work early. The court noted that if these facts were true, these employees would be “agents” and their participation in the tip pool would violate Labor Code section 351.

Shortly after Lu, the Court of Appeal issued a second opinion involving the casino industry. In Grodensky v. Artichoke Joe’s Casino, the casino had a mandatory tip pooling policy that required tips be divided among shift managers, floor managers, and other employees. The court found no evidence that the floor managers

were “agents.” They did not have the authority to hire or fire employees, set wages, benefits or work hours. Their primary job responsibilities were to start games, greet customers, make rulings on gambling disputes, etc. However, the shift managers were “agents” because they directed or controlled the acts of the dealers. Shift managers ensured that floor managers were performing their jobs, assigned the floor managers to sections and tables throughout the casino, had authority to send employees home, and would manage the casino when other higher-level managers were absent. Thus, the inclusion of shift managers in the tip pool was unlawful.

Is Direct Table Service Necessary?

There never has been any dispute that servers are permissible recipients of pooled tips. They usually donate the most income to the pool, and receive the greatest percentage from the pooled tips. These employees typically provide what the Leighton court and the California Department of Labor Standards Enforcement (“DLSE”) have described as “direct table service.” They are the “face” of the service end of the business.

In 1998, the DLSE issued an opinion letter in which it acknowledged the possibility that bartenders could participate in tip pooling because they might provide “direct table service.”

This idea recently came under scrutiny. In Budrow v. Dave & Buster’s, cocktail servers challenged the employer’s tip pooling policy that allowed bartenders to participate in the tip pool. The cocktail servers argued that the bartenders did not provide “direct table service” because they did not serve patrons at the dining tables. Rejecting the 1998 DLSE opinion letter, the Court of Appeal ruled that

Labor Code section 351 “does not distinguish between the functions performed by employees nor does it contain, on its face, the requirement that tip pools are limited to those providing direct table service.” Because section 351 does not limit tip pooling to employees who provide “direct table service,” the Court ruled that the bartenders, who indirectly provided service, could participate in a tip pool.

In the DLSE’s 1998 opinion letter, which followed the Leighton decision, the DLSE distinguished those employees who provide “direct table service” from those who do not. The agency specifically excluded dishwashers, cooks, and chefs from this category. Because kitchen staff do not typically provide “direct table service,” the presumption for the past 10 years has been that these employees do not need to be included in an employer mandated tip pool.

Kiss the Cook

Contrary to the DLSE’s position, the Court of Appeal recently ruled that kitchen staff can be included in tip pooling. In Etheridge v. Reins Int’l Cal., Inc., the employer had a mandatory tip pooling policy that allowed kitchen staff and dishwashers to participate in the tip pool. The servers filed suit claiming these employees could not receive pooled tips because they did not provide “direct table service.”

The court disagreed, holding that tip pooling was not limited to those employees who provided “direct table service,” but should extend to employees who participate in the “chain of service.” The court explained that a patron could decide to leave a small tip because the patron’s food had been cold and served on dirty plates despite the server’s excellent service. Similarly,

the patron could leave a good tip based not on the server, but on the presentation and taste of the food. Because the purpose behind tip pooling was fairness, the court ruled that it was only fair that tip pooling could extend to include kitchen staff, if the owner so desires.

How to Divide Pooled Tips

The general rule is that the division of pooled tips must be fair and reasonable. In Leighton, the Court found that a distribution of 80% to servers, 15% to busboys, and 5% to bartenders was fair and reasonable. While employers have the discretion to develop their own distribution amounts, employers must always ensure that such distribution is fair and reasonable. A tip pooling policy that shifts a large percentage of tips away from the employees directly involved in collecting them might now pass muster.

Private Right of Action for Violation of Labor Code Section 351

An employer who mandates an unlawful tip pooling policy may land in hot water with its employees. The Court of Appeal held in Lu that an employee did not have a private right to sue under Labor Code section 351 for unlawful tip pooling. Instead, the employee could use Labor Code section 351 as a predicate to a cause of action under California’s unfair competition law.

The First Appellate District issued the Grodensky decision after Lu. The Grodensky court ruled that an employee does have a private right to sue under Labor Code section 351. Accordingly, there is no clear direction at this point whether an employer may be subject to liability under Labor Code section 351. Employers should keep in mind, however, that employees can use different vehicles to bring suit for tip

pooling violations. As the court in Lu pointed out, an employee can sue under California's unfair competition law.

"Tips" for Tip Pooling

Lu, Budrow, Etheridge, and Grodensky, all court decisions issued within the past four months,

represent a change in the interpretation of California's tip pooling rules. With this recent activity, employers can expect the California Supreme Court to take one or more of these tip pooling issues up on review.

Employers are not required to adopt tip pooling. And, given the state of

the law, some employers may choose to eliminate their tip pooling policies until the California Supreme Court provides some further guidance on this issue. Employers who continue to mandate tip pooling should review their tip pooling policies to make sure they are consistent with applicable law and recent judicial decisions.

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