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Look before jumping in the pool – the tip pool, that is

AVAILABLE CASELAW AND AUTHORITIES ON WHAT IS "FAIR AND REASONABLE" FOR TIP-POOLING POLICIES

For those of us who practice either single-plaintiff and/or class action and PAGA cases, it is inevitable that you will take in at least one restaurant (or other service industry) case where the plaintiff or putative class members and aggrieved employees receive tips as a normal and regular part of their income. Many of these tips are thrown into a pool and are then supposed to be divided among the eligible employees. Often, this is perfectly acceptable and abides by the Labor Code. Sometimes, however, there are things that employers do that run afoul of the law as it relates to tip pooling and ownership of the tips.

What is a tip?

Labor Code section 350, subdivision (e) defines "gratuity" as follows: "'Gratuity' includes any tip, gratuity, money, or part thereof that has been paid or given to or left for an employee by a patron of a business over and above the actual amount due the business for services rendered or for goods, food, drink, or articles sold or served to the patron. Any amounts paid directly by a patron to a dancer employed by an employer subject to Industrial Welfare Commission Order No. 5 or 10 shall be deemed a gratuity."

But what is a "tip pool"?

A tip pool is the "practice by which tips left by patrons at restaurants and other establishments are shared among employees." (*Etheridge v. Reins International California, Inc.* (2009) Cal.App.4th 908.) In the restaurant industry, tip pooling has been around for decades, "which, through custom and usage, has become an industry policy or standard." (*Leighton v. Old Heidelberg, Ltd.* (1990) 219 Cal.App.3d 1062, 1067.) The general thinking behind having employees participate in a tip pool is to facilitate employers "ensur[ing] an equitable sharing of

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gratuities in order to promote peace and harmony among employees and provide good service to the public." (*Id.* at 1071.)

Given that California has embraced the practice of tip pooling for so many years, it is rather surprising that no California statute expressly addresses the practice of tip pooling. What is clear, however, is that the California Legislature intended to "ensure that employees, not employers, receive the full benefit of gratuities that patrons intend for the sole benefit of those employees who serve them." (*Leighton* at 1068; *accord, Chau v. Starbucks Corp.* (2009) 174 Cal.App.4th 688, 699.) "[S]ection 351 was enacted to prevent an employer from pressuring an employee to give the employer tips left for the employee." (*Ibid.*)

Gratuities belong to the employees

Labor Code section 351 lays out, at least in part, who can take part in a tip pool, what can be taken from tips, what cannot be deducted from tips, and to whom the tip belongs. Specifically, "[e]very gratuity is hereby declared to be the sole property of the employee or employees to whom it was paid, given, or left for." This code section also states that employers cannot take any portion of any gratuity left for an employee, make deductions from gratuities, or have their gratuities count as part of the employees' wages.

There are a few ways in which California diverges from the laws of other states. For example, in some states, employees in traditionally tipped positions like servers can make a much lower hourly wage, even below the federal minimum wage. In Ohio, as of January 1, 2024, the minimum wage for tipped employees is $5.25 per hour plus tips, and the employer is responsible to ensure that an employee's hourly wages plus tips average at least $10.45 per hour over an entire pay period. In stark contrast, California requires that all employees are paid at least the applicable minimum wage (which could vary by city, county, or even industry). As of January 1, 2024, here in California, the minimum wage for all employees is $16.00 per hour statewide. Fast food workers (who are not typically receiving gratuities, but some do) have a minimum wage of $20.00 per hour as of April 1, 2024. Simply, in California, gratuities do not count toward the minimum wages that must be paid to tipped employees.

California further diverges from the federal model in that Labor Code section 351 also prohibits an employer from charging fees on tips left on credit cards. FLSA rules regarding fee deductions will still apply to these types of fees, and some states expressly permit such charges, including Minnesota, New York, and Vermont, among others.

If tips belong to the employee to whom they were left, how can they be put into a pool?

In order to participate in a tip pool, the employees must participate in the "chain of service." The "chain of service" does not just mean servers. It can mean food runners, bartenders, dishwashers, cooks, and other kitchen staff, as their contributions participate in the "chain of service" that arguably resulted in the tip. (See *Budrow v. Dave & Buster's of California, Inc.* (2009) 171 Cal.App.4th 875.) In *Avidor v. Sutter's Place, Inc.* (2013) 212 Cal.App.4th 1439, the court also extended the practice of tip pooling to a casino setting that authorized a tip pool not just between direct dealers, but also allowed other casino personnel to participate, including other floor personnel, casino hosts, porters, and housekeepers.

Managers are generally prohibited from participating in the tip pool because, if they have sufficient supervisory duties to be considered agents instead of employees, including them in the tip pool would run afoul of Labor Code section 351. (*Etheridge v. Reins International California, Inc.* (2009) 172 Cal.App.4th 908.) Similarly, the California Supreme Court in *Lu v. Hawaiian Gardens Casino* expressly prohibited employers, managers, and supervisors from receiving money from a tip pool.

How much can be distributed to other employees?

This is truly the million-dollar question. The Department of Industrial Relations says it must be "fair and reasonable." What does that actually mean? Caselaw says the same thing. There must be a tip pool that ensures a fair distribution of the tips to the employees who earned it. Some tip pools have as high as a fifty-percent tip share, which would effectively require that an employee give up as much as half of the gratuities left for the server to others in the chain of service. Other than *Leighton*, there is a notable absence of approved percentages for tip pools in California. *Leighton* approved up to a twenty-percent tip pool.

Taking it back to the days of yore, there is a Division of Labor Standards Enforcement ("DLSE") Opinion Letter that is still available on the DLSE website today and has not, to the author's knowledge, been replaced by any other such opinion letter regarding tip pooling. The December 28, 1998, letter by the DLSE responds to a request by an attorney. (https://www.dir.ca.go v/dlse/opinions/1998-12-28-1.pdf) The DLSE Opinion Letter cites a scant two authorities on the issue of tip pooling: Labor Code section 351, and *Leighton*.

The Opinion Letter discusses excluding managers, as well as that "any tip pooling arrangement must be fair and reasonable." Indeed, in *Leighton*, 80% went to servers, 15% to "busboys," and 5% to the bartender. In *Leighton*, that total of 20% was found to be fair and reasonable. Interestingly, the Opinion Letter also discusses how the "percentages described in *Leighton* are not carved in stone[,] [b]ut if the purpose of tip pooling is to ensure a fair distribution of gratuities among those employees who provide direct table service to customers, there must be some reasonable relationship between the degree to which the employee or category of employee provides such table service and the distribution of pooled tips."

"Fair and reasonable" is now apparently up for interpretation and

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debate. That is why we have litigation, right? The Opinion Letter indicates that there is room for evaluation on a case-by-case basis, so there definitely is no bright line rule at which one percentage would be appropriate and another would not.

What claims do you have?

Labor Code section 351 does not create a private right of action. (*Lu v. Hawaiian Gardens Casino, Inc.* (2010) 50 Cal.4th 592, 595.) An employee, however, can pursue remedies "such as a common law action for conversion" for allegedly misappropriated tips "under appropriate circumstances." (*Id.* at 603-604.) This conversion cause of action could also be appropriate for class treatment, depending on the circumstances of the policy.

Lastly, even under the very recently overhauled Private Attorneys General Act ("PAGA"), California Labor Code section 2699.3, an aggrieved employee could have suffered a PAGA violation if an employer violates Labor Code section 351, even though there is no stand-alone private right of action for violating that section. Indeed, for every employee who participates in the tip pool who suffers a violation, including for instance, a violation where managers are participating in the tip pool or there is a "house cut" taken off the top of everyone's tips, there would be a violation of the PAGA on every single pay period.

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