

# California Wage/Hour Update



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## Tips on Tip Pooling

By Sarah Nichols (San Francisco)

In March a California court awarded more than \$105 million to Starbucks baristas due to the company's practice of permitting supervisors to share the tips. The case is significant to all California employers that have tip-sharing arrangements. *Chau v. Starbucks Corp.*

Prime targets for this type of litigation are employers in the gaming industry, the salon industry, automobile dealerships, and the restaurant industry. This is therefore a good time for employers to review how they are handling tips.

### Tip Pooling Regulations

Under California law, employers are allowed to create "tip pools" in which employees share customer gratuities among themselves. Employers *and their agents* do not receive any portion of the tips. Specifically, California Labor Code § 351 states:

*"No employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron..."*

In other words, these tips are "hands off" as to an employer or its agents because they are considered the separate property of the employees receiving them. "Agent" is defined as "every person other than the employer having the authority to hire or discharge any employee or supervise, direct, or control the acts of employees."

This is stricter than the federal law, the Fair Labor Standards Act, which permits tip pooling or sharing arrangements between employees who "customarily and regularly" receive tips. But the FLSA does not preempt state laws that provide *greater* protections to employees than the FLSA. So the general rule is that the law which is more protective to employees will apply.

In the *Chau* case, the issue was whether Starbucks' shift supervisors, who were responsible for assigning tasks to other employees as well as preparing and serving coffee and waiting on customers, were "agents" of Starbucks under California law.

### Definition of "Agent": Directing Employees is Enough

After nearly four years of litigation, San Diego Superior Court Judge Patricia Cowett ruled in *Chau's* favor, ordering the company to pay \$86.7 million plus 7 percent interest (totaling more than \$105 million *plus* attorneys' fees) in back tips. The ruling also prohibited Starbucks from allowing its shift supervisors to continue sharing in the tips in the future, holding that the shift supervisors were agents under California law.

Critics have argued that this was a very expansive reading of the California statute as it excludes employees who should be able to share in the tips both a) because of the service function of shift supervisors, and b) because the shift supervisor role enhances the level of service, making customers more likely to leave larger tips.

But in a similar case, *Jameson v. Five Feet Restaurant, Inc.* a California Court of Appeals held that the performance of *both* customer service *and* supervisory duties by restaurant floor managers did not prevent

the floor managers from being considered "agents" of the employer within the meaning of the law. Consistent with the holding in *Jameson*, Judge Cowett found that the shift supervisors were Starbucks' agents because they supervised and directed the baristas.

### Here's a Hot Tip: Time for a Check up

It is clear that California employers are taking a severe risk if they continue to permit shift supervisors to share in the tip pool. Classifying employees as non-exempt and paying them overtime does not necessarily insulate an employer from other potential wage and hour liabilities. As the *Chau* case shows, merely having the ability to "direct or control the acts of employees" is sufficient to exclude employees from sharing in the tip jar.

The primary lesson here is that you cannot mandate tip sharing rules just because it seems fair to split the tips between all employees involved in the chain of customer service. It is a common practice for servers to share gratuities with others in the service chain. Some employers have specific policies requiring servers to "tip out" colleagues. Others leave it up to the servers to decide whether and how they want to divide their tips.

But even if the tip-sharing arrangement is agreed upon by employees, it may result in significant costs if the arrangement is not compliant with both federal and state laws. In California, if an agreement violates California public policy, it will be void.

### And Don't Stop There

There are a number of other laws on tipping that you should be aware of. Federal law permits "tip credits" against the employer's minimum wage obligations (subject to certain conditions). This is prohibited under California law. Under Section 351, employers cannot deduct tips from the wages owed to the employee or credit that amount towards the employee's wages. In addition, the failure to keep records of gratuities is a misdemeanor under California law.

Compulsory service charges are not deemed tips under State law, but if paid to the employee, they are considered wages and must be included in the employee's regular rate of pay for the purposes of computing overtime. If the tip is paid using a credit card, you must pay employees the full amount of the tip on the credit card without any deduction for credit card payment processing fees or costs.

We strongly recommend a proactive approach: review your tipping procedures regularly. In fact, the proactive approach is best regarding all wage and hour issues in the workplace. At a minimum, you should seek to decrease potential liability with regular audits of your payroll practices and employee classifications. Make sure both are compliant with federal and state laws.

And be particularly careful during management turnovers to make sure new managers understand and abide by federal and California wage and hour laws.

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# Court Affirms: Holiday Pay Premiums May Be Credited Toward Overtime Obligations

By John Skousen (Irvine)

California law sets out basic overtime requirements for non-exempt employees in California. Among other things, the law requires an employer to pay an employee time and one-half of the employee's regular rate of pay for *both* 1) more than 8 hours of work in one workday, *and* 2) more than 40 hours of work in any workweek. A double time premium



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is required for hours in excess of 12 in a work day, or in excess of 8 hours on the seventh consecutive day of work in a work week.

In a recent decision, an appellate court ruled that an employer could use premium pay paid on a holiday, as a "credit" against the regular overtime amount. *Advanced-Tech Security Services, Inc.*

Advanced-Tech paid employees a premium rate of one and one-half times their regular rate of pay for work on designated holidays. An employee later sued claiming that she was entitled to time and one-half of the premium holiday pay as overtime if she worked more than 8 hours in a day or 40 hours in the work week containing the holiday.

In essence, the employee was claiming that the premium paid for the holiday hours should have been credited toward calculating an increased regular rate of pay in the overtime calculation. The employer argued that the premium amounts paid for the holiday work must be credited against overtime worked for the week.

The court held that the plain language of the law "does not require an employer to compensate an employee at a rate higher than one and one-half times the regular rate of pay under the circumstances presented here. The employer is entitled to credit the time and one-half premium pay on holidays against otherwise earned overtime."

## But Court Leaves the Door Open

The court limited its holding to what public policy required, noting that a long line of federal precedent required that the regular rate not be affected by the premium payment. The court further noted that its interpretation and holding permitting the premium to be credited against overtime due was consistent with a prior appellate decision (*Huntington Memorial Hospital v. Superior Court*) adopting the federal regulations in determining how California calculates the regular rate.

The court did not "quarrel" with the principle that a claim might have been brought for unpaid wages on a theory of breach of contract, but noted that the employee had not raised the issue of breach of contract in her complaint filed in trial court. So, the issue of whether there was a contract to pay any more than what public policy required was not before the court.

Although the employer prevailed in this case, this controversy emphasizes that employers should be vigilant in making sure that their holiday pay policies are clearly drafted so that employees do not have expectations of receiving overtime compensation beyond what the law requires. For example, if you choose to pay premium pay equivalent to overtime rates for what otherwise would be straight time work, include language in your policies that the premium pay will be credited against the week's overtime obligations as permitted by law.

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*Fisher & Phillips LLP represents employers nationally in labor, employment, civil rights, employee benefits, and immigration matters*

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