Duff on Hospitality Law

Bad News for Employers: In a Surprise, Ninth Circuit Upholds Tip Pooling Regulations

02.25.16

In the latest of a series of twists and turns regarding the legality of certain tip pools in Western states, on February 23, 2016, a divided three judge panel of the Ninth Circuit Court of Appeals validated regulations by the Department of Labor ("DOL") that significantly limit employers' ability to have tip pools that include more than "customarily and regularly tipped" employees. This development means that employers operating in states or territories in the Ninth Circuit (covering Washington, Oregon, Alaska, Idaho, Montana, Nevada, California, Arizona, Hawaii, Guam, and the Northern Mariana Islands) cannot include in their tip pools "back of the house" employees (such as cooks or dishwashers) or other employees who are not customarily tipped. We examine the impact of and history behind this decision below.

How did we get here?

Under the federal Fair Labor Standards Act ("FLSA"), with proper notice, an employer can use an employee's tips to offset a significant portion of the federal minimum wage. This is known as a "tip credit." Tip credits are illegal under Oregon and Washington law, but remain legal in many other states.

Under the FLSA, where an employer claims a tip credit toward the federal minimum wage, the employer may only require that employees pool tips with other employees who customarily and regularly receive tips. This requirement means that "back of the house" employees and other employees who do not regularly receive more than $30 in tips each month are not eligible to participate in a mandatory tip pool *if their employer takes a tip credit*. The FLSA is silent about who may participate in a mandatory tip pool if the employer does not claim a tip credit against the minimum wage.

The scope of mandatory tip pools in situations when the employer does not claim tip credits was the main subject of the 2010 case *Cumbie v. Woody Woo, Inc., dba Vita Cafe*, 596 P.2d 577 (9th Cir. 2010), a much-touted victory for the hospitality industry in the Ninth Circuit. In that case, the Ninth Circuit Court of Appeals rejected a waitstaff's claim against Vita Cafe in Portland, Oregon that the cafe's mandatory tip pool violated the FLSA because the pool included employees who did not regularly receive tips (in that case, kitchen employees). The court held that the FLSA's restriction on tip sharing among customarily and regularly tipped employees applies only when their employer claims the federal tip credit. Accordingly, after this decision, employers operating in the Ninth Circuit who did not claim a tip credit could legally require servers to share tips with "back of the house" employees who did not customarily receive tips.

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Unsurprisingly, and in direct response to the *Woody Woo* decision, in May 2011, DOL issued new regulations regarding tips. Under those regulations, DOL interpreted the FLSA such that tips are the property of the tipped employee (and no one else) regardless of whether an employer claims a tip credit against that employee's wages. As such, under the regulations, an employer cannot use an employee's tips except as a credit against minimum wage (if allowed by state law) or as part of a tip pool that only includes employees who regularly receive tips.

While the 2011 regulations were being prepared by DOL, the National Restaurant Association met with the agency several times to discuss how the regulations would be enforced in the Ninth Circuit in light of the *Woody Woo* decision. The agency assured the Association that it would not enforce the new rules in the Ninth Circuit. However, in an abrupt about-face, in February 2012 DOL issued a directive to its field investigators that explicitly rejected the *Woody Woo* decision and instructed them to enforce the new regulations nationwide, including in the Ninth Circuit.

In July 2012 several restaurant industry associations (including the Washington Restaurant Association and Oregon Restaurant and Lodging Association) and others filed a lawsuit in Oregon's federal court, challenging the validity of the 2011 DOL regulations. They argued that DOL exceeded its authority in issuing the regulations, and that the regulations were inconsistent with the plain language of the FLSA as well as of *Woody Woo.* They prevailed in summer 2013, when a federal judge ruled that DOL went beyond its authority when it issued regulations prohibiting the use of tips by an employer even when the employer does not take a tip credit. Specifically, Judge Michael Mosman held that Congress, through the FLSA, had intended to impose tip pooling conditions on employers who take a tip credit, but did not intend to impose a similar requirement for all tipped employees. As a result of this ruling, DOL's 2011 tip pooling regulations were invalidated for employers operating in the Ninth Circuit.

Unfortunately, DOL appealed the decision to the Ninth Circuit Court of Appeals, where it was consolidated with another similar appeal regarding control over casino workers' tips. Legal experts expected that the Court of Appeals would affirm the Oregon federal court's decision, given that judges from the same court decided *Woody Woo* in employers' favor just a few years ago. However, as discussed above, a divided three judge panel issued a surprise ruling in February 2016, concluding that DOL did in fact have authority to issue the 2011 regulations. The complete decision is available to read here.

Where do we go from here?

There is still a slight chance that the Ninth Circuit Court of Appeals' decision may be reconsidered by 11 judges of the court (called an *en banc* hearing), or considered on appeal to the United States Supreme Court. However, neither of these outcomes is likely. As it stands, the law under this new ruling does not permit mandatory tip pools that include anyone (like back of the house workers) other than regularly and customarily tipped employees. This is a major shift, as such tip pools appeared safe in the Ninth Circuit for the last five years.

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In light of this ruling, employers with mandatory tip pools should change the parameters of their programs to eliminate sharing with employees who do not customarily receive tips. Or, as an alternative, such employers could consider implementing a non?discretionary service charge to be shared more broadly among employees (more on that option here). Either way, every employer's situation is different, and we recommend seeking legal counsel before making any changes to tip pools.

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Tagged as back of house employees, Department of Labor, DOL, Fair Labor Standards Act, Federal Minimum Wage, FLSA, National Restaurant Association, Ninth Circuit, Ninth Circuit Court of Appeals, Oregon, Oregon Restaurant and Lodging Association, Tip Credit, tip pooling conditions, tip pools, Washington Restaurant Association

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