

Signed: October 30, 2017.

John J. Manfreda,
Administrator.

Approved: November 30, 2017.

Timothy E. Skud,

Deputy Assistant Secretary (Tax, Trade and
Tariff Policy).

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DEPARTMENT OF LABOR

Wage and Hour Division

29 CFR Part 531

RIN 1235-AA21

Tip Regulations Under the Fair Labor Standards Act (FLSA)

AGENCY: Wage and Hour Division,
Department of Labor.

ACTION: Notice of proposed rulemaking;
request for comments.

SUMMARY: The Department of Labor (Department) is proposing to rescind portions of its tip regulations issued pursuant to the Fair Labor Standards Act that impose restrictions on employers that pay a direct cash wage of at least the full federal minimum wage and do not seek to use a portion of tips as a credit toward their minimum wage obligations. This Notice of Proposed Rulemaking (NPRM) seeks the views of the public on the Department's proposed rescission of those portions of the regulations.

DATES: Comments must be received on or before January 4, 2018.

ADDRESSES: To facilitate the receipt and processing of written comments on this NPRM, the Department encourages interested persons to submit their comments electronically. You may submit comments, identified by Regulatory Information Number (RIN) 1235-AA21, by either of the following methods:

Electronic Comments: Follow the instructions for submitting comments on the Federal eRulemaking Portal <http://www.regulations.gov>.

Mail: Address written submissions to Melissa Smith, Director of the Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue NW., Washington, DC 20210.

Instructions: This NPRM is available through the **Federal Register** and the <http://www.regulations.gov> Web site. You may also access this document via the Wage and Hour Division's (WHD) Web site at <http://www.dol.gov/whd/>.

All comment submissions must include the agency name and Regulatory Information Number (RIN 1235-AA21) for this NPRM. Response to this NPRM is voluntary. The Department requests that no business proprietary information, copyrighted information, or personally identifiable information be submitted in response to this NPRM. Submit only one copy of your comment by only one method (e.g., persons submitting comments electronically are encouraged not to submit paper copies). Please be advised that comments received will become a matter of public record and will be posted without change to <http://www.regulations.gov>, including any personal information provided. All comments must be received by 11:59 p.m. on the date indicated for consideration in this NPRM; comments received after the comment period closes will not be considered. Commenters should transmit comments early to ensure timely receipt prior to the close of the comment period. Electronic submission via <http://www.regulations.gov> enables prompt receipt of comments submitted as DOL continues to experience delays in the receipt of mail in our area. For access to the docket to read background documents or comments, go to the Federal eRulemaking Portal at <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT:

Melissa Smith, Director of the Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue NW., Washington, DC 20210, telephone: (202) 693-0406 (this is not a toll-free number). Copies of this NPRM may be obtained in alternative formats (Large Print, Braille, Audio Tape or Disc), upon request, by calling (202) 693-0675 (this is not a toll-free number). TTY/TDD callers may dial toll-free 1 (877) 889-5627 to obtain information or request materials in alternative formats.

Questions of interpretation and/or enforcement of the agency's regulations may be directed to the nearest WHD district office. Locate the nearest office by calling the WHD's toll-free help line at (866) 4US-WAGE ((866) 487-9243) between 8 a.m. and 5 p.m. in your local time zone, or log onto WHD's Web site at <http://www.dol.gov/whd/america2.htm> for a nationwide listing of WHD district and area offices.

SUPPLEMENTARY INFORMATION:

I. Executive Summary

The Fair Labor Standards Act of 1938 (FLSA) generally requires covered employers to pay employees at least a

Federal minimum wage, which is currently \$7.25 per hour. See 29 U.S.C. 206(a)(1). Under section 3(m) of the FLSA, which defines the term "wage," an employer of tipped employees can satisfy its obligation to pay those employees the Federal minimum wage by paying a lower direct cash wage and counting a limited amount of the tips received by its employees as a partial credit to satisfy the difference between the direct cash wage paid and the Federal minimum wage (known as a "tip credit"), if it follows certain statutory requirements. See 29 U.S.C. 203(m).

In 1966, Congress created a tip credit provision within the definition of a "wage" in section 3(m) of the statute that permitted an employer to utilize tips received by its employees to subsidize up to 50 percent of its minimum wage obligations. See Public Law 89-601, 101(a), 80 Stat. 830 (1966); 76 FR 18,832, 18,838.¹ In 1974, Congress again amended section 3(m) by providing that an employer could not utilize tips received by its employees toward its Federal minimum wage obligation unless, among other things:

(1) [its] employee has been informed by the employer of the provisions of this subsection and (2) all tips received by such employee have been retained by the employee, except that this subsection shall not be construed to prohibit the pooling of tips among employees who customarily and regularly receive tips.

Public Law 93-259, 13(e), 88 Stat. 55 (1974). Thus, section 3(m) permits an employer to take a partial credit against its minimum wage obligations on account of tips received by its employees but only if, among other things, its tipped employees retain all of their tips. Section 3(m), however, does not preclude an employer that takes a tip credit from implementing a tip pool in which tips are shared only among those employees who "customarily and regularly receive tips." *Id.*

The Department first promulgated regulations implementing the section 3(m) tip credit in 1967. See 32 FR 13,575 (Sept. 28, 1967). In 2011, the Department updated those regulations to reflect its then-existing view that the statutory conditions in section 3(m) of the FLSA require that tipped employees retain all of their tips, except for those tips distributed through a tip pool limited to customarily and regularly tipped employees, regardless whether such employees work for an employer that takes a tip credit. See, e.g., § 531.52.

¹ As discussed further below, Congress changed the amount of tips received by employees that an employer can credit against its minimum wage obligation in subsequent amendments to the FLSA. See, *infra*, Sec. III.

As discussed below, since 2011 there has been a significant amount of private litigation involving the tip pooling and tip retention practices of employers that pay a direct cash wage of at least the Federal minimum wage and do not take a tip credit. There has also been litigation directly challenging the Department's authority to promulgate the 2011 Final Rule as it applies to employers that pay a direct cash wage of at least the Federal minimum wage. At the same time, there have been changes in state laws that require employers to pay their tipped employees a direct cash wage of at least the Federal minimum wage, which have resulted in more employers being unable to claim a tip credit.

In part because of these developments, the Department is concerned about the scope of its current tip regulations as applied to employers that pay the full Federal minimum wage to their tipped employees. The Department is also seriously concerned that it incorrectly construed the statute in promulgating the tip credit regulations that apply to such employers. Additionally, the Department seeks to consider whether it is unnecessary to prohibit the sharing of tips with employees who do not customarily receive tips, including restaurant cooks, dishwashers, and other traditionally lower-wage job classifications, when their employer does not take a tip credit under FLSA section 3(m) and its employees are paid at least the full Federal minimum wage.

The Department is therefore proposing to rescind the parts of its tip regulations that bar tip-sharing arrangements in establishments where the employers pay full Federal minimum wage and do not take a tip credit against their minimum wage obligations. This proposed rule applies only to employers that pay direct cash wages of at least the Federal minimum wage and do not take a tip credit. It does not apply to employers who pay less than the Federal minimum wage and take a tip credit.

The proposed removal of the regulatory limitation on an employer's ability to utilize tips if it pays a direct wage of at least the full FLSA minimum wage will allow for employers to provide in their agreements² with

employees for tip sharing among a larger tip pool of employees. This change could result, for example, in tips being shared with employees who are not customarily and regularly tipped, such as back-of-the-house employees in restaurants. This type of tip sharing was at issue in *Cumbie v. Woody Woo, Inc.*, 596 F.3d 577 (9th Cir. 2010) (employer paid its tipped employees a direct wage payment that exceeded the Federal minimum wage and instituted a tip pool that included back-of-the-house employees who did not customarily and regularly receive tips, such as dishwashers and cooks). If the Department's rule were adopted as proposed herein, it would expressly allow such tip sharing. Employers in other industries could also adopt similarly varied tip pooling arrangements among tipped and non-tipped employees. *E.g.*, *Cesarz v. Wynn Las Vegas*, 2014 WL 117579 (D. Nev. 2014), *rev'd and remanded by Oregon Rest. & Lodging Ass'n v. Perez*, 816 F.3d 1080 (9th Cir. 2016), *reh'g and reh'g en banc denied*, 843 F.3d 355 (9th Cir. 2016), *pet. for cert. filed* (Aug. 1 2016) (employer instituted a tip pool through which dealers' tips were shared with other casino employees in jobs that have not traditionally been customarily and regularly tipped). Promulgation of the regulation would also make clear that where an employer does not claim the tip credit under section 3(m) and pays a direct wage that satisfies the FLSA's minimum wage requirements, the treatment and disposition of tips is a matter of agreement between the employer and employees or of state law.

To estimate the impact of the proposed rule, the Department looked at two occupations that constitute a large percentage of tipped workers (waiters, waitresses, and bartenders) and focused on two industries (drinking places and full-service restaurants). Based on the data used in the regulatory impact analysis below, the Department estimated that there are up to 1,298,231 tipped workers in the selected occupations, and 206,770 full-service restaurants, and 40,095 drinking places.

There are labor market forces that will affect decisions concerning employer use or reallocation of tips. For example, there are certain market factors that may discourage any changes in tip-sharing practices, such as employee resistance and heightened turnover among the customarily tipped employees. The Department is unable to quantify how customers will respond to proposed

regulatory changes, which in turn would affect total tipped income and employer behavior. The Department currently lacks data to quantify possible reallocations of tips through newly expanded tip pools to employees who do not customarily and regularly receive tips. The Department presents a primarily qualitative approach to assessing the benefits and transfers of the new rule.

The Department estimated the regulatory familiarization costs associated with this proposed rule on an establishment basis and calculated the first year cost to be \$3.431 million. The Department discussed other impacts and benefits of the proposed rule qualitatively. For the purposes of E.O. 13771, it is expected that this proposed rule would, if finalized as proposed, qualify as an "E.O. 13771 deregulatory action."

II. Recent Developments in Tip Pooling Regulations and Litigation; Proposed Changes to Regulations; and Nonenforcement Policy

As noted above, the FLSA's tip credit provision was enacted in 1966. WHD promulgated regulations implementing the FLSA's tip credit provision in 1967. *See* 29 U.S.C. 203(m), Public Law 89-601, 101(a), 80 Stat. 830 (1966); 32 FR 13,575 (Sept. 28, 1967). Among other things, the 1967 regulations acknowledged that employers and employees could agree that tips received would belong to the employer, which might then use the tips to satisfy the entirety of its minimum wage obligations, thus exceeding the then-50 percent limitation on an employer's crediting of tips received by its employees against its minimum wage obligations. *See, e.g.*, § 531.55(b) (1967) ("[I]f pursuant to an employment agreement the tips received by an employee must be credited or turned over to the employer, such sums may, after receipt by the employer, be used by the employer to satisfy the monetary requirements of the Act. In such instances there is no applicability of the 50-percent limitation on tip credits provided by section 3(m).").

The 1967 regulations were consistent with *Williams v. Jacksonville Terminal Co.*, 315 U.S. 386 (1942), and the legislative history of the 1966 amendments. In *Jacksonville Terminal*, the Supreme Court held that an employer had complied with the FLSA's minimum-wage requirements by paying its employees only those tips that the employees received from customers and, if tips received by any employee did not satisfy the minimum wage, by paying the difference to that employee.

² Similar references to agreements in this notice refer to agreements, whether written or otherwise, between an employer and its employees regarding the treatment and disposition of tips received by such employees. *Cf. Williams v. Jacksonville Terminal Co.*, 315 U.S. 386, 397 (1942) (determining that, "[i]n businesses where tipping is customary, the tips, in the absence of an explicit contrary understanding, belong to the recipient," but that

"an arrangement [may be] made by which the employee agrees" to a different disposition of such tips).

Id. at 388–389, 397–398, 403–408. The Court reasoned that such tips “belong to the recipient” employee “in the absence of an explicit contrary understanding,” but that an employer and its employees could agree that the employer would “take the compensation paid by [customers] for the service [provided by the employees], whether paid as a fixed charge or as a tip.” *Id.* at 397–398. The Court ultimately concluded that the parties in the case had entered, and the FLSA did not prohibit, such an agreement to “transfer the tips [collected by the employees] . . . to the credit of the [employer].” *Id.* at 403; *see id.* at 403–408. The 1966 legislative history similarly reflected that the new statutory “tip provisions [we]re sufficiently flexible to permit the continuance of existing practices with respect to tips,” including practices under which “an employer and his tipped employees . . . agree that all tips are to be turned over or accounted for to the employer to be treated by him as part of his gross receipts.” S. Rep. 1487, 89th Cong., 2d Sess. 12 (1966). In that circumstance, however, “the employer must pay the employee the full minimum hourly wage, since for all practical purposes the employee is not receiving tip income.” *Id.*

When it amended section 3(m) in 1974, Congress added the requirement that an employer taking a tip credit must permit its tipped employees to retain all of their tips, except for those tips distributed through a mandatory tip pool that includes only employees who customarily and regularly receive tips. *See* Public Law 93–259, 13(e). Immediately after the 1974 amendments, WHD stated that its existing regulations were superseded by the amendments to the extent that they were in conflict with those amendments, in particular, those provisions that permitted an employer to use tips received by its employees toward its minimum wage obligations to a greater extent than permitted by section 3(m). *See* Wage and Hour Opinion Letter FLSA–626, 1974 WL 422051 (June 21, 1974), at *2; Wage and Hour Opinion Letter WH–310, 1975 WL 40934, at *1 (Feb. 18, 1975); Wage and Hour Opinion Letter WH–321, 1975 WL 40945, at *1–2 (Apr. 30, 1975). However, although the statutory tip credit provision was significantly amended in 1974 and thereafter, WHD did not revise its 1967 tip credit regulations until 2011. *See* 76 FR 18,832, 18,854–56 (Apr. 5, 2011).

In 2008, the Department published a Notice of Proposed Rulemaking that proposed, among other things, to amend WHD’s tip credit regulations to reflect

the 1974 amendments to the FLSA. *See* 73 FR 43,654, 43,659 (July 28, 2008). Before it had finalized that rulemaking, the Department participated as *amicus curiae* in support of a tipped employee challenging her employer’s tip pooling arrangement in *Cumbie v. Woody Woo*, a case before the Ninth Circuit. 596 F.3d 577. *Woody Woo* involved an employer that paid its tipped employees a direct wage payment that exceeded the Federal minimum wage and instituted a mandatory tip pool that included back-of-the-house employees who do not customarily and regularly receive tips, such as dishwashers and cooks. *Id.* at 578–79. The district court in *Woody Woo* had concluded that section 3(m)’s restrictions on tip pooling apply only when an employer takes a tip credit against its minimum wage obligations. *See Cumbie v. Woody Woo, Inc.*, 2008 WL 2884484, at *3 (D. Or. July 25, 2008). The Department argued before the Ninth Circuit that the district court’s interpretation would permit an employer to use tips received by its employees to a greater extent than that permitted in section 3(m), since it would permit an employer to use tips to meet its entire minimum wage obligation or to subsidize the wages of non-tipped employees. *See* Br. of the Sec’y of Labor as Amicus Curiae, Apr. 29, 2009, at 8, 2009 WL 2609879, *Cumbie v. Woody Woo, Inc.*, 596 F.3d 577 (9th Cir. 2010). On February 23, 2010, the Ninth Circuit issued an opinion in *Cumbie v. Woody Woo*, which held in the context of an employer that did not use tips to pay its employees the minimum wage, that section 3(m)’s tip retention requirements apply only to employers that avail themselves of the tip credit provision. 596 F.3d 577, 581 (9th Cir. 2010).

The Department finalized its revisions to the tip regulations in 2011. *See* 76 FR 18,832, 18,854–56 (revising, among other provisions, §§ 531.52, 531.54, and 531.59). Those regulations, among other things, bar all employers from sharing tips with employees who do not customarily and regularly receive tips—regardless whether the employers take a tip credit. *See, e.g.*, § 531.52. The Department’s regulations thus provide that an employer is prohibited from using tips received by employees, whether or not it has taken a tip credit, except as a credit against its minimum wage obligations to the employee to the extent permitted by that section, or in furtherance of a tip pool that is permissible under that section. *Id.*

On July 12, 2012, the Oregon Restaurant and Lodging Association (ORLA), along with the National

Restaurant Association, Washington Restaurant Association, Alaska Cabaret, Hotel, Restaurant & Retailers Association, and others (the ORLA Plaintiffs), challenged the Department’s authority to promulgate the 2011 Final Rule as it applies to employers that do not take a tip credit and that pay a direct cash wage of at least the Federal minimum wage. *See* Compl., July 12, 2012, *Oregon Rest. & Lodging Ass’n v. Solis*, 948 F.Supp.2d 1217 (D. Or. 2013). The ORLA Plaintiffs sought to have those parts of the Department’s 2011 tip regulations that apply to employers that do not take a tip credit against their minimum wage obligations declared invalid and vacated. *See id.* at 33–34 (identifying §§ 531.52, 531.54, and 531.59).

The plaintiffs alleged, inter alia, that such tip regulations are contrary to the FLSA’s clear statutory language in section 3(m), which places restrictions on an employer’s use of tips *only when the employer takes a tip credit*. *See id.* at 18–21. The Department responded by arguing that the FLSA does not address an employer’s use of tips when the employer does not take a tip credit, and that the Department appropriately used its rulemaking authority to address that statutory gap through the 2011 tip regulations. *See* Reply Br. of the Sec’y of Labor, Dec. 7, 2012, at 5–8, *Oregon Rest. & Lodging Ass’n v. Solis*, 948 F.Supp.2d 1217 (D. Or. 2013). On June 7, 2013, the district court granted the plaintiffs’ motion for summary judgment, ruling that the 2011 tip regulations were invalid. *Oregon Rest. & Lodging Ass’n v. Solis*, 948 F.Supp.2d 1217, 1227 (D. Or. 2013). The court concluded that the regulations were contrary to the clear intent of Congress to limit the use or pooling of tips only to employers that elect to take a tip credit. *See id.* at 1226.

On August 21, 2013, the Department appealed the district court’s decision to the Ninth Circuit. *See* Br. of the Sec’y of Labor, Dec. 27, 2013, at 8, *Oregon Rest. & Lodging Ass’n v. Perez*, 816 F.3d 1080 (9th Cir. 2016) (ORLA). In its brief, the Department argued that the 1974 amendments to the FLSA expressly delegated broad authority to the Department to implement the terms of the amendments and that the Department properly used this authority to promulgate the 2011 tip regulations, which address a gap in the statutory scheme: Whether an employer that does not take a tip credit is subject to section 3(m)’s restrictions. *See id.* at 24–28. The Department further argued that the regulations were necessary to prevent a circumvention of section 3(m)’s limitations on an employer’s ability to

use or require the pooling of tips. *See id.* at 32–33. The Ninth Circuit consolidated the case with *Cesarz v. Wynn Las Vegas*—a private FLSA action in which the plaintiffs-employees, relying on the Department’s 2011 regulations, alleged that the employer violated the FLSA when it required its tipped employees to share their tips with non-tipped employees, *see* 2014 WL 117579, at *1 (D. Nev. 2014)—for purposes of oral argument and disposition. *See* 816 F.3d 1080 n.* (9th Cir. 2016).³

On February 23, 2016, the Ninth Circuit, reversing the district court, upheld the validity of the 2011 tip regulations in *ORLA v. Perez*, 816 F.3d 1080, 1090 (9th Cir. 2016). In deciding *ORLA*, the Ninth Circuit concluded that *Woody Woo* held only that section 3(m) does not prohibit employers that do not take a tip credit from instituting an invalid tip pool. *See id.* at 1088. Having found that the FLSA is silent with respect to employers that do not take a tip credit, the Ninth Circuit concluded that the 2011 tip regulations were a reasonable application of the agency’s authority to fill gaps left by the text of the FLSA, because the “purpose of the Act does not support the view that Congress intended permanently to allow employers that do not take a tip credit to do whatever they wish with their employees’ tips.” *See id.* at 1089–1090. On April 6, 2016, the *ORLA* Plaintiffs filed a petition for panel rehearing and

rehearing *en banc*. *See* Pet. for Panel Reh’g and Reh’g En Banc, Apr. 6, 2016, *ORLA v. Perez*, 816 F.3d 1080 (9th Cir. 2016). The *ORLA* Plaintiffs argued that the Ninth Circuit’s decision in *ORLA* cannot be reconciled with *Woody Woo* and reiterated their contention that the 2011 tip pooling regulation is an impermissible interpretation of the FLSA. *See id.* at 11, 13.

On September 6, 2016, the *ORLA* panel denied the plaintiffs’ request for panel rehearing, and a majority of the non-recused active judges voted to decline *en banc* review. *See ORLA v. Perez*, 816 F.3d 1080, *reh’g and reh’g en banc denied*, 843 F.3d 355, 356 (9th Cir. 2016).

Judge O’Scannlain, joined by nine other judges, dissented. *See id.* (O’Scannlain, J., dissenting). Judge O’Scannlain concluded that the Department’s tip pooling regulation is precluded because the Ninth Circuit previously held in *Woody Woo* that the FLSA “clearly and unambiguously permits employers who forgo a tip credit to arrange their tip-pooling affairs however they see fit.” *See id.* at 358 (citing *Cumbie v. Woody Woo*, 596 F.3d at 579 n.6, 581, 581 n.11, 582, 583; *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 984 (2005)). Based on this statutory construction, Judge O’Scannlain wrote, “[T]he Department has not been delegated authority to ban tip pooling by employers who forgo the tip credit, and [as such] the Department’s assertion of regulatory jurisdiction is manifestly contrary to the statute and exceeds [its] statutory authority.” *Id.* at 363–64 (internal quotation marks omitted).

The National Restaurant Association (and other plaintiffs in the *OLRA* litigation) filed a petition for certiorari with the Supreme Court, asking for review of the Ninth Circuit’s decision in *ORLA*, and that petition is pending. *See* Sup. Ct. No. 16–920 (certiorari petition filed Jan. 19, 2017). The *Wynn* Defendants filed their own petition for certiorari with the Supreme Court on August 1, 2016, which is also still pending. Sup. Ct. No. 16–163 (certiorari petition filed (Aug. 1 2016)).

As explained further in Part IV, below, more employers are unable to claim a tip credit in 2017 than when the Department’s regulations were promulgated in 2011 due to the increased number of states that require employers to pay their tipped employees a direct cash wage of at least the Federal minimum wage. Perhaps because of these changes to state law, there has been a significant amount of private litigation in recent years involving the tip pooling and tip

retention practices of employers that pay a direct cash wage of at least the Federal minimum wage. Much of that litigation involves the application of the Department’s 2011 tip credit regulations that bar employers from retaining and from sharing tips with employees who do not customarily and regularly receive tips, even when the employers have not taken a tip credit. For example, in *Trejo v. Ryman Hospitality Properties*, the employees alleged that their employer, which had paid its tipped employees a direct cash wage of at least the Federal minimum wage, improperly required its tipped employees to contribute to a tip pool including employees who were not customarily and regularly tipped. *Sazzad v. Ryman Hosp. Properties*, No. 8:13–cv–02911 (D. Md., April 21, 2014), *aff’d sub nom, Trejo*, 795 F.3d 442 (4th Cir. 2015); *see also Malivuk, 2016 WL 3999878, aff’d on other grounds*,—F. App’x —, 2017 WL 2491498 (11th Cir. June 9, 2017); *see also Brueningsen v. Resort Express Inc.*, 2015 WL 339671 (D. Utah Jan. 26, 2015), *recons. denied*, 2016 WL 1181683 (D. Utah Mar. 25, 2016), *appeal filed* (10th Cir., Nov. 16, 2016). *Wynn*, 2014 WL 117579 (D. Nev. 2014) (employees alleged that the employer improperly required them to contribute to a tip pool that included their supervisors), *rev’d and remanded by ORLA*, 816 F.3d 1080 (9th Cir. 2016), *reh’g and reh’g en banc denied*, 843 F.3d 355 (9th Cir. 2016), *pet. for cert. filed* (Aug. 1 2016). Therefore, the application of the Department’s regulations to employers who do not take a tip credit has gained increasing importance in recent years.

Additionally, the Tenth Circuit recently ruled in *Marlow v. The New Food Guy*, a private FLSA case in which the United States participated as amicus curiae, that the Department’s 2011 tip regulations are invalid to the extent that they bar an employer from using or sharing tips with employees who do not customarily and regularly receive tips when the employer pays a direct cash wage of at least the Federal minimum wage and does not claim a section 3(m) tip credit. *See Marlow v. New Food Guy, Inc.*, 861 F.3d 1157 (10th Cir. 2017). In *Marlow*, the plaintiff alleged that the employer, which paid the plaintiff a direct wage of at least the Federal minimum wage and did not claim a section 3(m) tip credit, violated section 3(m) and the Department’s 2011 regulations by retaining the tips employees received from customers. *Id.* at 1158–59. The district court dismissed the plaintiff’s claim, concluding that the employer satisfied its obligations under the FLSA and that section 3(m) does not

³ While *ORLA* was pending before the Ninth Circuit, the Fourth Circuit heard *Trejo v. Ryman Hospitality Properties, Inc.*, an appeal from a district court’s dismissal of a private FLSA action in which plaintiffs—whose employer did not claim the tip credit—sought to recoup tips that their employer required them to pay into an allegedly invalid tip pool. 795 F.3d 442 (4th Cir. 2015). The Department submitted a brief as amicus curiae arguing that the 2011 tip-pooling regulation was valid and entitled to deference, but also pointing out that the FLSA provides a cause of action only to recover unpaid minimum wages or overtime compensation under sections 6 and 7 of the FLSA, rather than to recover tips in and of themselves under section 3(m), and that plaintiffs had expressly disclaimed any minimum wage violation. *See* Br. of the United States as Amicus Curiae, Jan. 2015, at *12, *13, 2015 WL 191535, *Trejo*, 795 F.3d 442 (4th Cir. 2015). In other words, and as explained further in footnote 10, *infra*, Plaintiffs did not argue that the effect of the invalid tip pool was to reduce their wages below the minimum wage, which would present a valid cause of action under the FLSA. *See id.* at *12 (citing 29 U.S.C. 216(b) (private right of action limited to enforcing the FLSA’s minimum wage and overtime compensation provisions); *see also* 29 U.S.C. 216(c) (imposing similar limitations on the Secretary’s ability to enforce the FLSA)). The Fourth Circuit concluded that section 3(m) “simply does not contemplate a claim for wages other than minimum wage or overtime wages.” *Trejo*, 795 F.3d at 448 (internal quotation marks omitted). *See also Malivuk v. Ameripark*, 2016 WL 3999878, *aff’d on other grounds*,—F. App’x —, 2007 WL 2491498, (11th Cir. June 9, 2017).

provide a cause of action for lost tips. *Marlow v. New Food Guy, Inc.*, No. 15–CV–01327, 2016 WL 4920980, at *1 (D. Colo. Feb. 17, 2016).⁴ On appeal, the United States, while also defending the validity of the Department of Labor’s 2011 tip regulations, argued as a threshold matter that the plaintiff failed to plead a claim under the FLSA because she did not allege that her employer’s retention of her tips resulted in a minimum wage or overtime violation. *See* Br. of the United States as Amicus Curiae, Oct. 2016, 2016 WL 6566326, at *10. The Tenth Circuit affirmed the district court’s dismissal of the plaintiff’s claim, holding that the text of the FLSA limits an employer’s use of tips only when the employer takes a tip credit, “leaving [the Department] without authority to regulate to the contrary.” *See Marlow*, 861 F.3d at 1163–64.⁵

The Department has taken into account the changed landscape and extensive litigation since promulgating its 2011 Final Rule. In that regard, the dissent to the denial of the petition for rehearing *en banc* in *ORLA* is notable, not only because of the force of that opinion but also because it drew the support of nine other judges in the Ninth Circuit. After considering the *ORLA* rehearing dissent and the Tenth Circuit’s decision in *Marlow*, both of which state that the Department’s 2011 Final Rule exceeded the agency’s authority under section 3(m), the Department is reconsidering its regulations to the extent that they apply to employers that pay a direct wage of at least the Federal minimum wage and do not claim a credit based on tips to satisfy their minimum wage obligation. The Department has serious concerns that it incorrectly construed the statute in promulgating its current regulations, the scope of which extends to employers that have paid the full Federal minimum wage to their tipped employees, particularly insofar as those employers, rather than taking the tips for their own purposes, provide for such tips to be shared with other employees through a tip pool. The Department also has independent and serious concerns about those regulations as a policy

matter. In particular, the Department seeks to remove prohibitions on sharing tips with employees who do not customarily and regularly receive tips—including restaurant cooks, dishwashers, and other traditionally lower-wage job classifications—when their employer does not take a tip credit under FLSA section 3(m) and all employees are paid at least the full Federal minimum wage. In light of all of these factors, the Department is proposing to rescind the parts of its tip regulations that apply to employers that pay a direct cash wage of at least the full Federal minimum wage and do not take a tip credit against their minimum wage obligations. The Department also issued a nonenforcement policy on July 20, 2017, whereby WHD will not enforce the Department’s regulations on the retention of tips received by employees with respect to any employee who is paid a cash wage of not less than the full FLSA minimum wage (\$7.25) and for whom their employer does not take an FLSA section 3(m) tip credit either for 18 months or until the completion of this rulemaking, whichever comes first.⁶ This nonenforcement policy provides nationwide consistency while the

⁶ This nonenforcement policy extends the agency’s partial nonenforcement policy already in effect. In *Oregon Restaurant and Lodging Ass’n v. Solis*, 948 F. Supp. 2d 1217 (D. Or. 2013), the U.S. District Court for the District of Oregon declared the Department’s 2011 regulations that limit an employer’s use of tips received by its employees when the employer has not taken a tip credit against its minimum wage obligations to be invalid, and imposed injunctive relief, as described below. Notwithstanding the Ninth Circuit’s decision in *ORLA* reversing that decision, the Department continues to be constrained by the injunctive relief entered by the district court until the Ninth Circuit issues its mandate, which formally notifies the district court of the court of appeals’ decision; issuance of that mandate has been stayed “until final disposition [of this litigation] by the Supreme Court.” *ORLA v. Perez*, No. 13–35765 (9th Cir. Sept. 13, 2016). For these reasons, the Department is currently prohibited from enforcing its tip retention requirements against the Oregon Restaurant and Lodging Association plaintiffs (which include several associations, one restaurant, and one individual) and members of the plaintiff associations that can demonstrate that they were a member on June 24, 2013. The plaintiff associations in the Oregon litigation were the National Restaurant Association, Washington Restaurant Association, Oregon Restaurant and Lodging Association, and Alaska Cabaret, Hotel, Restaurant, and Retailer Association. As a matter of enforcement policy, the Department decided that while the injunction is in place it will not enforce its tip retention requirements against any employer that has not taken a tip credit in jurisdictions within the Ninth Circuit. The Ninth Circuit has appellate jurisdiction over the states of California, Nevada, Washington, Oregon, Alaska, Idaho, Montana, Hawaii, and Arizona; Guam; and the Northern Mariana Islands. *See* WHD, Fact Sheet #15: Tipped Employees Under the Fair Labor Standards Act (FLSA), <https://www.dol.gov/whd/regs/compliance/whdfs15.pdf> (last accessed June 12, 2017).

Department moves forward with rulemaking.

III. Legislative and Regulatory History of the Section 3(m) Tip Credit

As discussed above, Congress amended the FLSA’s tip credit provision in 1974 to require an employer that elects to take a tip credit against its minimum wage obligations to permit its tipped employees to retain all tips they receive, except for those distributed through a tip pool limited to customarily and regularly tipped employees. *See* Public Law 93–259, § 13(e). The legislative history emphasizes that the employee-tip-retention requirement was not “intended to discourage the practice of pooling, splitting, or sharing tips with employees who customarily and regularly receive tips—*e.g.*, waiters, bellhops, waitresses, countermen, busboys, [and] service bartenders, etc.” S. Rep. No. 93–690, at 43 (1974). “On the other hand,” the Report explains, “the employer will lose the benefit” of the tip credit if tipped employees are required to share their tips with employees who do not customarily and regularly receive tips—*e.g.*, janitors, dishwashers, chefs, laundry room attendants, etc.” *Id.*⁷

The language from the 1974 amendments to section 3(m) is essentially the same as the current version of the law. *See* 29 U.S.C. 203(m). Although section 3(m)’s tip credit provision has been amended three times since 1974—in 1977, 1989, and 1996—these amendments changed only the applicable amount of tips received by employees that could be used as a credit against an employer’s minimum wage obligations. *See* Public Law 95–151, § 3(b), 91 Stat. 1245 (1977); Public Law 101–157, § 5, 103 Stat. 938 (1989); and Public Law 104–188, § 2105(b), 110 Stat. 1755 (1996).⁸ In

⁷ The Department has concluded that employer-mandated tip pools described in section 3(m) may also include employees in occupations with duties analogous to those of the Senate’s list of “employees who customarily and regularly receive tips” (“waiters, bellhops, waitresses, countermen, busboys, service bartenders”), such as barbacks. *See* Field Operations Handbook 30d04(b). Likewise, the Department has concluded that employees who do not customarily and regularly receive tips, and therefore may not be included in an employer-mandated tip pool described in § 3(m), include employees in occupations with duties analogous to the Senate’s list of non-customarily tipped occupations (“janitors, chefs or cooks, dishwashers, laundry room attendants”), such as salad preparers and prep cooks. *See* Field Operations Handbook 30d04(f).

⁸ The 1977 amendments to the FLSA decreased the section 3(m) tip credit to a maximum of 40 percent of the Federal minimum wage, while the 1989 amendments returned it to a maximum of 50

⁴ Following the Ninth Circuit’s decision in *ORLA*, the plaintiff moved for reconsideration of the district court’s decision. *See Marlow*, 861 F.3d at 1159. The district court denied the plaintiff’s motion, expressing its agreement with the *ORLA* dissent. *See id.*; Order on Plaintiff’s Motion for Reconsideration, *Marlow*, No. 15–CV–01327 (D. Co. Apr. 4, 2016).

⁵ The plaintiff in *Marlow* petitioned for panel rehearing of the Tenth Circuit’s decision, which the Court denied on July 20, 2017. *See* Order on Appellant’s Petition for Panel Rehearing, *Marlow*, No. 16–1134 (10th Cir. July 20, 2017).

amendments to the FLSA in 2007, Congress increased the minimum wage in three steps to \$7.25 per hour beginning July 2009, but did not change the definition of “wage” in section 3(m) for purposes of applying the tip credit formula. Public Law 110–28, § 8102(a), 121 Stat. 112 (2007). Thus, the maximum tip credit that an employer is permitted to claim under section 3(m) today is \$5.12 per hour—the current Federal minimum wage, \$7.25 per hour, 29 U.S.C. 206(a)(1), minus \$2.13—or 71 percent of the current Federal minimum wage. See 76 FR 18,832, 18,839.

As explained above, the Department promulgated its initial tip regulations in 1967, one year after Congress created the tip credit in section 3(m), and several years before the 1974 amendments to section 3(m)’s tip provisions. 32 FR 13,575 (Sept. 28, 1967). Consistent with the Department’s understanding of the 1966 amendments, the 1967 tip regulations permitted agreements under which tips received by employees would be turned over to the employer, which could then use the tips to pay the Federal minimum wage. Cf. S. Rep. 1487, 89th Cong., 2d Sess. 12 (1966) (explaining that such practices could continue under the 1966 amendments).

Shortly after the 1974 statutory amendments, however, the Department addressed the impact of the amendments on its tip regulations and stated that its then-existing regulations were superseded by the amendments to the extent that they were in conflict. Specifically, when asked about the legality of an agreement under which “the employer would retain all monies generated by tips” and directly pay its employees at the minimum wage rate, the Department stated that “[t]he amendments to section 3(m) of the Act,” which specified that an employer’s wage credit for tips (up to 50% of the minimum wage) could not exceed the amount of tips actually received by the employee, “would have no meaning or effect unless they prohibit agreements under which tips are credited or turned

percent of the Federal minimum wage. See Public Law 95–151, §§ 2(a), 3(b), 91 Stat. 1245 (1977); Public Law 101–157, §§ 2, 5, 103 Stat. 938 (1989). The 1996 amendments “froze” the direct cash wage that an employer must pay its tipped employees under section 3(m) at a minimum of 50 percent of the minimum wage in effect on the date of their enactment, or \$2.13 per hour. See Public Law 104–188, §§ 2104(b), § 2105(b), 110 Stat. 1755 (1996). This change shifted the amount of the maximum tip credit from a fixed percentage of the current Federal minimum wage to the difference between the current Federal minimum wage and the frozen minimum direct cash payment, thus allowing the percentage of the Federal minimum wage covered by the tip credit to increase as the minimum wage rose.

over to the employer for use by the employer in satisfying the monetary requirements of the Act.” See Wage and Hour Opinion Letter FLSA–626, 1974 WL 422051, at *2 (June 21, 1974).

The Department opined shortly after the 1974 amendments that “an employer may not take advantage of Section 3(m) by using any part of his employee’s tips as a credit to meet his monetary obligation unless the employee is permitted to keep all tips” and, if an employer takes tips received by an employee, “then, in order to come into compliance, such employer must return the tips and pay the full statutory minimum wage.” Wage and Hour Opinion Letter WH–310, 1975 WL 40934, at *1 (Feb. 18, 1975); see Wage and Hour Opinion Letter WH–386, 1976 WL 41739, at *3 (July 12, 1976) (“[E]mployers must pay tipped employees at least half of the applicable minimum wage (from their own pockets) for each hour worked, and may take a tip credit of no more than 50 percent of the required minimum wage.”). To conclude otherwise, the Department reasoned, would enable an employer to circumvent section 3(m)’s restriction that employers use no more than a limited portion of tips received by employees to satisfy their Federal minimum wage obligations. Cf. *Woody Woo*, 596 F.3d at 579 n.7.

The opinion letters issued shortly after the 1974 amendments were primarily focused on whether it would constitute an impermissible circumvention of section 3(m) of the Act for an employer to utilize tips received by its employees to satisfy its minimum wage obligations to a greater extent than Congress expressly permitted in the Act’s tip credit provision. In a 1989 opinion letter, however, the Department opined that merely requiring tipped employees to participate in a tip pool that is not limited to employees in customarily and regularly tipped occupations—*i.e.*, a tip pool in a form not expressly authorized by section 3(m)—may also violate the FLSA, even when an employer has paid all of the tipped and non-tipped employees in the pool a direct cash wage equal to or greater than the Federal minimum wage. See Wage and Hour Opinion Letter WH–536, 1989 WL 610348, at *3 (Oct. 26, 1989). In that letter, the Department stated that tips are an employee’s property even when an employer pays a direct cash wage of at least the full Federal minimum wage and does not claim a tip credit against its minimum wage obligations based on erroneous

reasoning⁹ and, on that premise, concluded that a tipped employee who is required to participate in a tip pool that does not satisfy the criteria in section 3(m) is effectively required to “contribute part of his or her property to the employer or to other persons for the benefit of the employer.” *Id.* at *2. Thus, under the erroneous reasoning reflected in that letter, even when an employer does not claim a tip credit to reduce the direct cash wage it pays and does not use tips to fulfill any part of its minimum wage obligation to its tipped employees, mandating that a tipped employee contribute to a pool that includes employees in occupations that do not customarily and regularly receive tips “would become an issue under the minimum wage provisions of the Act,” if the “employer does not pay a sufficiently high cash wage to reimburse such employee for such loss, plus at least the minimum wage.” *Id.*¹⁰

In 2011, the Department issued a Final Rule addressing tip pooling and other uses of tips. See 76 FR 18,832, 18,842. Revised § 531.52 provides in relevant part that:

⁹The opinion letter, in the context of an employer that did not take a 3(m) tip credit, stated that “[t]he courts have made clear that tips are the property of the employee to whom they are given.” 1989 WL 610348, at *2 (citing *Barcellona v. Tiffany English Pub, Inc.*, 597 F.2d 464, 466–467 (5th Cir. 1979)). The Department acknowledges that that statement is incorrect. *Barcellona* concluded that “[i]f there was no agreement as to ownership, then the tips were the property of the recipient,” and that the *trial evidence in that particular case* supported the factual finding that no such agreement existed. 597 F.2d at 467 (emphasis added) (citing *Williams v. Jacksonville Terminal Co.*, 315 U.S. 386, 397 (1940)); cf. *Richard v. Marriott Corp.*, 549 F.2d 303, 304–305 (4th Cir. 1977) (concluding that “tips belong to the employee to whom they are left” in circumstances in which no contrary agreement existed and the employer simply undertook to pay “the difference between the tips and the [minimum] hourly wage”).

¹⁰The Department similarly stated in the preamble to the 2011 Final Rule that, if, by requiring tipped employees to participate in a tip pool that does not satisfy the standards in section 3(m) or by claiming and using the tips itself, such an employer deducts sufficient tips to “reduce the employer’s direct wage payment to an amount below the minimum wage,” the employer would violate section 6 of the FLSA and be subject to suit under section 16 or 17. 76 FR 18,832, 18,842; see also Notice of Proposed Rulemaking, 73 FR 43,654, 43,659 (July 28, 2008) (explaining that if an “employer paid the employee a direct wage in excess of the minimum wage” it “would be able to make deductions [from the employee’s tips] so long as they did not reduce the direct wage payment below the minimum wage”); Br. of the United States as Amicus Curiae, Jan. 2015, at 2, 2015 WL 191535, *Trejo v. Ryman Hospitality Indus.*, 795 F.3d 442 (4th Cir. Jan. 2015) (pointing out that private plaintiffs who did not allege that the effect of their employers’ tip pool was to reduce their wages below the minimum wage in violation of section 6 failed to plead a cause of action under the FLSA because section 3(m) of the Act does not provide a freestanding right to recover tips).

Tips are the property of the employee whether or not the employer has taken a tip credit under section 3(m) of the FLSA. The employer is prohibited from using an employee's tips, *whether or not it has taken a tip credit*, for any reason other than that which is statutorily permitted in section 3(m): As a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool.

Id. at 18,855 (emphasis added). Under the current regulations an employer that pays a direct cash wage equal to or greater than the Federal minimum wage—just like an employer that claims a tip credit to reduce the direct cash wage it pays—may require tipped employees to participate in a tip pool that is limited to employees in customarily and regularly tipped occupations, but it may not require tipped employees to participate in a tip pool that includes employees who are not in customarily and regularly tipped occupations. Nor may an employer that pays a direct cash wage equal to or greater than the Federal minimum wage use its tips received by its employees for any other purpose.

IV. Recent Changes in State Tip Pooling Laws

As a result of market forces and changes in state wage laws, the number of employers paying tipped employees a direct cash wage that is equal to or greater than the Federal minimum wage (and thus not claiming a section 3(m) tip credit) has increased since the Department promulgated the 2011 Final Rule. The Department believes that these changes also merit reconsideration of the tip pooling restrictions imposed on employers that do not claim a tip credit under section 3(m).

Historically, six western states (Alaska, California, Montana, Nevada, Oregon, and Washington) have prohibited employers from using tips received by employees as a credit against their state minimum wages—all of which today equal or exceed the Federal minimum wage—thereby preventing employers in these states from claiming a section 3(m) tip credit to reduce the direct cash wage they pay without incurring liability under state law. *See* Alaska Stat. § 23.10.065(a); Cal. Lab. Code § 351 (amended 1975); Mont. Code Ann. §§ 39-3-402, 39-2-404 (originally enacted Sec. 2, Ch. 417 (1971)), Mont. Admin. R. 24.16.1508(1); Nev. Rev. Stat. § 608.160(1)(b); Or. Rev. Stat. § 653.035; Rev. Code Wash. 49.46.020, Wash. Admin. Code 296-126-022 (effective 1974); *see also* Alaska School Bus Safety Act, 1990 Alaska Laws Ch. 12, § 23.10.065 (1990); *Henning v. Industrial Welfare*

Commission, 46 Cal. 3d 1262, 1275-76 (Cal. 1988) (holding that Labor Code section 351, as amended in 1975, “bar[s] the establishment of a minimum wage for tipped employees lower than the generally applicable minimum wage.”); *Moën v. Las Vegas Int’l Hotel, Inc.*, 402 F. Supp. 157, 158 (D. Nev. 1975) (outlining requirements of Nev. Rev. Stat. § 608.160); Wash. Att’y Gen. Op. 1974 No. 18, 1974 WL 168752 (concluding that hotels and restaurants must pay the full Washington minimum wage to their tipped employees, and may not take advantage of the section 3(m) tip credit, since, “as it has long been administratively construed by the department of labor and industries, tips are . . . not included as a part of an employee’s wages for the purposes of the Washington law.”); WHD, Minimum Wages for Tipped Employees, January 1, 2003, <https://www.dol.gov/whd/state/tipped2003.htm>.¹¹

Since the Department promulgated the 2011 Final Rule, a number of additional states have increased the direct cash wage an employer must pay some or all tipped employees under state law. In August 2014, Minnesota—which prohibits employers from taking a tip credit against the state minimum wage—increased its minimum wage for large employers from \$6.15 per hour to \$8.00 per hour (it was increased on August 1, 2016 to \$9.50 per hour) and increased its minimum wage for small employers from \$5.25 per hour to \$7.25 per hour beginning in August 2015 (it is currently \$7.75 per hour). *See* Minn. Stat. Ann. § 177.24, subd. 1, 2; 2014 Minn. Sess. Law Serv. Ch. 166. As a result, employers in Minnesota now must pay tipped employees a direct cash wage that is greater than the Federal minimum wage. In January 2015, Hawaii—which permits employers to take a tip credit but requires that the combined cash wage and tips must equal at least \$7.00 more than the state minimum wage—increased the direct cash wage employers must pay tipped employees to \$7.25 per hour (the current Federal minimum wage). Haw. Rev. Stat. Ann. § 387-2. The minimum direct cash wage an employer must pay a tipped employee in Hawaii is currently \$8.50 per hour and is scheduled to increase to

¹¹ Additionally, Connecticut has required employers to pay bartenders a direct cash wage of at least the Federal minimum wage since 2001. *See* Conn. Gen. Stat. Ann. 31-58, 31-60; Conn. Pub. Act. No. 00-144 (May 26, 2000). Connecticut currently requires bartenders to be paid a direct cash wage of at least \$8.23 per hour. *See* Conn. Gen. Stat. Ann. 31-58, 31-60. It permits employers to pay other tipped employees a minimum direct cash wage of \$6.38. *See id.*

\$9.35 in January 2018. Haw. Rev. Stat. Ann. § 387-2. In December 2015, New York increased the direct cash wage employers that take a tip credit must pay tipped food service employees and other service employees to at least \$7.50 per hour. *See* 12 NY ADC 146-1.3 (Dec. 4, 2015).¹² And in November 2016, Arizona and Colorado enacted ballot measures that will increase the direct cash wage employers that take a tip credit must pay tipped employees to at least the current Federal minimum wage by January 2020. *See* Ariz. Proposition 206, approved Nov. 8, 2016 (amending Ariz. Rev. Stat. Ann. § 23-363(C)); 2016 Colo. Legis. Serv. Init. Pet. 101 (amending Colo. Const. art. XVIII, § 15).

Due to these changes, the share of servers, bellhops and porters, counter attendants, bartenders, and dining room attendants and bartender helpers¹³ with employers that are or will be required under state law to pay a direct cash wage of at least the Federal minimum wage to all or a portion of their tipped employees has almost doubled, from approximately 17 percent in 2011 to approximately 31 percent today. *See* Table A: WHD Analysis of BLS Data Regarding States that Require Employers to Pay Tipped Employees a Direct Cash Wage At Least Equal to the Federal Minimum Wage.

V. The Department Is Proposing To Rescind Portions of Its Tip Regulations

The Department seeks public comments, which should include supporting data whenever possible, on the proposed rescission of those portions of its 2011 tip regulations that apply to employers that pay tipped employees a direct cash wage that is equal to or greater than the Federal minimum wage and that do not claim a tip credit. The Department’s current regulations require that tipped employees retain all tips they receive regardless whether the employer takes a

¹² Effective December 31, 2016, New York has four schedules of direct cash wages that employers must pay tipped service workers and food service workers based on employer size and geographic location. *See* N.Y. Comp. Codes R. & Regs. tit. 12, § 146-1.3. Currently, the lowest direct cash wage an employer can pay to a tipped food service worker in any part of the state is \$7.50 per hour and the lowest direct cash wage an employer can pay a tipped service employee in any part of the state is \$8.10 per hour. *See id.*

¹³ The BLS occupational categories of “Waiters and Waitresses,” “Baggage Porters and Bellhops,” “Counter Attendants, Cafeteria, Food Concession, and Coffee Shop,” “Bartenders,” and “Dining Room and Cafeteria Attendants and Bartender Helpers” most closely correspond to the illustrative list of “customarily and regularly tipped” occupations in the Senate Report accompanying the 1974 amendments to the FLSA: “waiters, bellhops, waitresses, countermen, busboys, [and] service bartenders.” *See* S. Rep. No. 93-690, at 43 (1974).

tip credit under section 3(m). Employers can only require tipped employees to participate in a mandatory tip pool if the tip pool is limited to employees in customarily and regularly tipped occupations, such as servers, bartenders, and bussers. As discussed above, this regulatory restriction limiting tip pools to only customarily and regularly tipped employees applies even when an employer pays a direct cash wage of at least the full Federal minimum wage and does not claim a credit pursuant to section 3(m).

The purpose of section 3(m)'s tip credit provision is to allow an employer to subsidize a portion of its Federal minimum wage obligation by crediting the tips customers give to employees. If an employer takes a tip credit against its wage obligations, section 3(m) applies, along with its attendant protections that restrict the employer's use of tips received by its employees. Where an employer has paid a direct cash wage of at least the full Federal minimum wage and does not take the employee tips directly, a strong argument exists that the statutory protections of section 3(m) do not apply.¹⁴ But if an employer pays

the full Federal minimum wage and does not take a tip credit, the proposed rule would allow tip sharing in a manner currently prohibited by regulation, including by sharing tips with employees who are not customarily and regularly tipped (*e.g.*, restaurant cooks and dishwashers) through a tip pool. The proposed rule, therefore, provides such employers and employees greater flexibility in determining the pay policies for tipped and non-tipped workers. It additionally allows them to reduce wage disparities among employees who all contribute to the customers' experience and to incentivize all employees to improve that experience regardless of their position. In sum, due to the Department's serious concerns that it incorrectly construed the statute in promulgating its current tip regulations to cover employers who pay a direct cash wage of at least the full Federal minimum wage, as well as the various other reasons described in this NPRM, the Department is proposing to rescind the portions of the current regulations that apply to employers that pay a direct

cash wage of at least the Federal minimum wage and do not claim a tip credit against their minimum wage obligations.

This NPRM uses the term "tip pooling" to describe any scenario in which a tip provided by a customer to an employee or group of employees is shared, in whole or in part, with other employees. The Department recognizes that in some workplaces or under State laws, the term "tip pooling" may refer to a narrower set of practices, and that employers and workers may use other terms—for example "tip out," "tip sharing," or "tip jar"—to describe certain practices regarding tips. Accordingly, the Department asks commenters to define in their comments any terms they use to describe practices regarding tips. The Department will consider information provided by the public in response to this NPRM in finalizing its proposal to amend 29 CFR part 531, subpart D, as it applies to situations where an employer pays tipped employees a direct cash wage that is at least the Federal minimum wage.

TABLE A—WHD ANALYSIS OF BLS DATA REGARDING STATES THAT REQUIRE EMPLOYERS TO PAY TIPPED EMPLOYEES A DIRECT CASH WAGE AT LEAST EQUAL TO THE FEDERAL MINIMUM WAGE

State	Servers (waiters & waitresses) SOC Code 353031	Bartenders SOC Code 353011	Counter attendants, cafeteria, food concession, and coffee shop SOC Code 353022	Dining room and cafeteria attendants and bartender helpers SOC Code 359011	Baggage porters & bellhops SOC Code 396011	Servers; bartenders; counter attendants; dining room & cafeteria attendants & bartenders helpers; porters & bellhops
Direct cash wage for tipped employees at least equal to the Federal minimum wage, 2011¹⁵						
Alaska	3690	1930	1550	1020	190	8380
California	233330	45280	61040	61380	4800	405830
Montana	8780	4550	690	1060	90	15170
Nevada	37380	13420	3960	11050	3080	68890
Oregon	26530	9340	5100	3320	340	44630
Washington	41160	12530	19080	8430	920	82120
Subtotal	350870	86450	91420	86260	9420	624420
Total, U.S.	2289010	512230	441830	391290	44130	3678490
% U.S. total	15.33%	16.88%	20.69%	22.05%	21.35%	16.97%
Direct cash wage for tipped employees equal to or scheduled to reach at least Federal minimum wage, present¹⁶						
Alaska	4260	1740	2540	920	90	9550
Arizona	53580	11150	8340	9610	740	83420
California	280100	57340	47970	71460	5660	462530
Colorado	52540	12560	4530	7490	640	77760
Connecticut	28430	7740	5480	3430	180	45260

¹⁴ If an employer pays its tipped employees a direct cash wage of at least the full Federal minimum wage but takes its employees' tips to satisfy the entirety of its minimum wage obligation,

there is a question as to whether the employer is circumventing the protections of section 3(m) because it is utilizing its employees' tips towards its minimum wage obligations to a greater extent

than permitted under the statute for employers that take the tip credit. The Department will consider whether additional guidance on this circumvention issue should be issued in the future.

TABLE A—WHD ANALYSIS OF BLS DATA REGARDING STATES THAT REQUIRE EMPLOYERS TO PAY TIPPED EMPLOYEES A DIRECT CASH WAGE AT LEAST EQUAL TO THE FEDERAL MINIMUM WAGE—Continued

State	Servers (waiters & waitresses) SOC Code 353031	Bartenders SOC Code 353011	Counter attendants, cafeteria, food concession, and coffee shop SOC Code 353022	Dining room and cafeteria attendants and bartender helpers SOC Code 359011	Baggage porters & bellhops SOC Code 396011	Servers; bartenders; counter attendants; dining room & cafeteria attendants & bartenders helpers; porters & bellhops
Hawaii	16110	3200	5470	5130	1380	31290
Minnesota	50230	17270	15060	4040	330	86930
Montana	8540	5340	870	1040	70	15860
Nevada	39450	14870	4670	13070	2710	74770
New York	155540	43670	31470	33390	4250	268320
Oregon	33100	9040	9950	4270	270	56630
Washington	48380	13520	13380	8240	520	84040
Subtotal	770260	197440	149730	162090	16840	1296360
Total, U.S.	2564610	603320	499550	423080	44750	4135310
% U.S. total	30.03%	32.73%	29.97%	38.31%	37.63%	31.35%

VI. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.*, and its attendant regulations, 5 CFR part 1320, require the Department to consider the agency's need for its information collections, their practical utility, as well as the impact of paperwork and other information collection burdens imposed on the public, and how to minimize those burdens. The PRA typically requires an agency to provide notice and seek public comments on any proposed collection of information contained in a proposed rule. *See* 44 U.S.C. 3506(c)(2)(B); 5 CFR 1320.8.

This NPRM does not contain a collection of information subject to OMB approval under the Paperwork Reduction Act. The Department welcomes comments on this determination.

VII. Analysis Conducted in Accordance With Executive Order 12866, Regulatory Planning and Review, Executive Order 13563, Improved Regulation and Regulatory Review, and Executive Order 13771, Reducing Regulation and Controlling Regulatory Costs

Under Executive Order 12866, the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs determines whether a

regulatory action is significant and, therefore, subject to the requirements of the Executive Order and review by OMB. 58 FR 51735. Section 3(f) of Executive Order 12866 defines a "significant regulatory action" as an action that is likely to result in a rule that: (1) Has an annual effect on the economy of \$100 million or more, or adversely affects in a material way a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as economically significant); (2) creates serious inconsistency or otherwise interferes with an action taken or planned by another agency; (3) materially alters the budgetary impacts of entitlement grants, user fees, or loan programs, or the rights and obligations of recipients thereof; or (4) raises novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. *Id.* OMB has determined that this proposed rule is a "significant regulatory action" under section 3(f) of Executive Order 12866.

Executive Order 13563 directs agencies to propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs; it is tailored to impose the least burden on society, consistent with achieving the regulatory objectives; and in choosing among alternative regulatory approaches, the agency has selected those approaches that maximize net benefits. Executive Order 13563 recognizes that some benefits are

difficult to quantify and provides that, where appropriate and permitted by law, agencies may consider and discuss qualitatively values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts.

Executive Order 13771 ("E.O. 13771") directs agencies to reduce regulation and control regulatory costs by eliminating at least two existing regulations for each new regulation, and by controlling the cost of planned regulations through the budgeting process. *See* 82 FR 9339. In relevant part, OMB defines an "E.O. 13771 regulatory action" as "a significant regulatory action as defined in section 3(f) of E.O. 12866 that has been finalized and that imposes total costs greater than zero."¹⁷ By contrast, an "E.O. 13771 deregulatory action" is defined as "an action that has been finalized and has total costs less than zero."¹⁸ For the purposes of E.O. 13771, it is expected that this proposed rule would, if finalized as proposed, qualify as an "E.O. 13771 deregulatory action."

A. The Need for Rulemaking

As explained earlier in Part IV of this notice, more employers are unable to claim a tip credit in 2017 than when the Department's regulations were promulgated in 2011 due to the increased number of states that require employers to pay their tipped

¹⁵ These employment figures are from the May 2011 BLS Occupational Employment Statistics (OES) Survey.

¹⁶ These employment figures are from the May 2016 BLS OES Survey.

¹⁷ OIRA Memo M-17-21, Guidance Implementing Executive Order 13771 (April 5, 2017).

¹⁸ *Id.*

employees a direct cash wage of at least the current \$7.25 per hour Federal minimum wage. Perhaps because of these changes to state law, there has been a significant amount of private litigation in recent years involving the tip pooling and tip retention practices of employers that pay a direct cash wage of at least the Federal minimum wage. See, e.g., *Trejo v. Ryman Hosp. Properties*, 795 F.3d 442 (4th Cir. 2015); *Aguila v. Corp. Caterers IV*, 199 F. Supp. 3d 1358 (S.D. Fla. 2016), *aff'd sub nom.* 2017 WL 1101081 (11th Cir. Mar. 24, 2017); *Marlow v. The New Food Guy, Inc.*, 861 F.3d 1157 (10th Cir. 2017).

In part because of these developments, the Department has serious concerns that it incorrectly construed the statute in promulgating its current tip regulations as applied to employers that have paid the full Federal minimum wage to their tipped employees, and serious concerns about the regulations as a policy matter, especially under changed circumstances. Additionally, the Department seeks to remove prohibitions on sharing tips with non-customarily tipped employees—including restaurant cooks, dishwashers, and other traditionally lower-wage job classifications—when their employer does not take a tip credit under FLSA section 3(m) and all employees are paid at least the full Federal minimum wage. The Department is therefore proposing to rescind the portions of its tip regulations at 29 CFR part 531, subpart D that limit employee arrangements to share tips by imposing restrictions on employers that pay a direct cash wage of at least the full Federal minimum wage and do not claim a tip credit against their minimum wage obligation. The Department also issued a nonenforcement policy on July 20, 2017, whereby WHD will not enforce the Department's regulations on the retention of employees' tips with respect to any employee who is paid a cash wage of not less than the full FLSA minimum wage (\$7.25) and for whom their employer does not take an FLSA section 3(m) tip credit, either for 18 months or until the completion of this rulemaking, whichever comes first.

B. Economic Analysis

i. Introduction

This economic analysis provides a quantitative analysis of the rule familiarization costs of the proposed rule, and a qualitative discussion of the benefits and transfers that may result

from the proposed rule.¹⁹ The potential benefits and transfers have not been quantified in this NPRM.

There are labor market forces that will affect employers' decisions on tips that employees receive. For example, there are certain market factors that may cause employers not to change their practices with respect to tips, such as employee resistance and a decline in employee morale, as well as the costs of employee turnover. The Department is unable to quantify how customers will respond to proposed regulatory changes, which in turn would affect total tipped income and employer behavior.

The Department welcomes comments that provide data or information regarding the potential benefits and transfers of this proposed rule, and has asked some specific questions that may help the Department quantify benefits and transfers in the Final Rule analysis. See Section VII.B.iv.

ii. Estimated Number of Affected Workers and Firms

This section explains the methodology used to estimate the number of workers who are defined as a tipped employee, *i.e.*, where a tipped employee means any employee engaged in an occupation in which he or she customarily and regularly receives more than \$30 a month in tips. See 29 U.S.C. 203(t). In the absence of data to specifically categorize employees by the definition above, the Department relied on a broader definition as allowed by the available data, where the minimum tip amount received is relaxed (that is, this analysis does not consider the \$30-a-month threshold), and where the focus is on tipped employees who are classified under two Bureau of Labor Statistics (BLS) Standard Occupational Classification (SOC) codes: SOC 35–3031 (Waiters and Waitresses) and SOC 35–3011 (Bartenders).

For the present analysis, the Department considered these two occupations as they constitute a large percentage of tipped workers.²⁰ The

¹⁹ The Department focused on two industries, which are classified under the North American Industry Classification System (NAICS) as 722410 (Drinking Places (Alcoholic Beverages)) and 722511 (Full-service Restaurants, the focus is on tipped employees who are classified under two Bureau of Labor Statistics (BLS) Standard Occupational Classification (SOC) codes: SOC 35–3031 (Waiters and Waitresses) and SOC 35–3011 (Bartenders).

²⁰ Source: Bureau of Labor Statistics, Current Population Survey, Table 11b. Employed Persons by Detailed Occupation and Age, 2016 (<https://www.bls.gov/cps/cpsaat11b.pdf>). The number of bartenders and wait staff were calculated as a percentage of total employment in 11 occupations in which compensation depends heavily on tips. The 11 occupations are based on a 2014 Congressional Budget Office report, "The Effects of

Department understands that there are other occupations with tipped workers such as SOC 35–9011 (Dining room and Cafeteria Attendants and Bartender Helpers) and SOC 35–9031 (Hosts and Hostesses, Restaurant, Lounge, and Coffee Shop), and others; thus, the Department welcomes comments and suggestions on whether this analysis should extend to additional tipped occupations. The Department focused on employees in those two occupations in the two industries in which they are primarily concentrated. The two industries are classified under the North American Industry Classification System (NAICS) as 722410 (Drinking Places (Alcoholic Beverages)) and 722511 (Full-service Restaurants). The Department understands that there are other industries with tipped workers, and welcomes comments and suggestions on whether this analysis should extend to those additional industries, and if so, which industries and why.

The Department used the Current Population Survey (CPS), a large, nationally representative sample of the labor force, for data on the number of workers employed in the two occupations mentioned above, the wages for these workers, and their usual hours worked. The CPS, which is sponsored jointly by the U.S. Census Bureau and BLS, is a monthly survey of about 60,000 households. In any given month, one adult household member reports employment and other information for each member of the household.²¹ Households are surveyed for four months, excluded from the survey for eight months, surveyed for an additional four months, then permanently dropped from the sample. During the last month of each rotation in the sample (month 4 and month 16), employed respondents complete a supplementary questionnaire in addition to the regular survey. These households and questions form the CPS Merged Outgoing Rotation Group (CPS–MORG) and provide more detailed information about those surveyed.

The CPS asks respondents whether they usually receive overtime pay, tips, and commissions, which allows the Department to estimate the number of bartenders and wait staff in restaurants

a Minimum-Wage Increase on Employment and Family Income" (<https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/44995-MinimumWage.pdf>).

²¹ See Current Population Survey, U.S. Census Bureau, <https://www.census.gov/programs-surveys/cps.html> (last visited July 17, 2017); CPS Merged Outgoing Rotation Groups, NBER, <http://www.nber.org/data/morg.html> (last visited July 17, 2017).

and drinking places who receive tips. CPS data, however, are not available separately for overtime pay, tips, and commissions, but the Department assumes very few bartenders and wait staff at restaurants and drinking places receive commissions, and the number who receive overtime pay but not tips

is also assumed to be minimal. Therefore, where bartenders and wait staff responded affirmatively to this question, the Department assumes that they receive tips.

All data tables in this analysis include estimates for the year 2016 as the baseline. Table 1 presents the estimates

of the share of bartenders and wait staff in restaurants and drinking places who reported that they usually earned overtime pay, tips, or commissions in 2016. Approximately 61 percent of bartenders and 57 percent of wait staff reported usually earning overtime pay, tips, or commissions in 2016.

TABLE 1—SHARE OF BARTENDERS AND WAITERS/WAITRESSES IN RESTAURANTS AND DRINKING PLACES WHO EARNED OVERTIME PAY, TIPS, OR COMMISSIONS, 2016

Occupation	Number of bartenders and waiters/waitresses in restaurants and drinking places	Number who responded Yes to earning overtime pay, tips, or commissions	Percent who responded Yes to earning overtime pay, tips, or commissions
Total	2,265,705	1,298,231	57
Bartenders	357,727	218,989	61
Waiters and waitresses	1,907,979	1,079,243	57

Source: 2016 Current Population Survey. The Department used DataFerrett to extract basic monthly CPS data.

Occupations: Bartenders (Census Code 4040) and Waiters and Waitresses (Census Code 4110).

Industries: Restaurants and other food services (Census Code 8680) and Drinking places, alcoholic beverages (Census Code 8690).

The Department used data from BLS' Quarterly Census of Employment and Wages (QCEW) to estimate the familiarization cost (Section VII.B.iv). The Department believes regulatory familiarization will occur at the specific establishment level rather than the broader firm level.²²

iii. Qualitative Analysis

Under this NPRM, employers that pay at least the full FLSA minimum wage directly to tipped employees could utilize some or all of the tips received by employees for purposes currently prohibited by the regulations (*i.e.*, for purposes other than a tip pool limited to customarily and regularly tipped employees) or when employers that currently claim the section 3(m) tip credit increase the cash wages of their tipped employees to at least the full FLSA minimum wage and then utilize some or all of the tips received by employees for purposes currently prohibited by the regulations.²³

The Department does not attempt to definitively interpret individual state

law, and is therefore unable to determine to what extent state law will affect employer behavior in light of the proposed changes. It is assumed, however, that about 30 percent of all waiters and waitresses and bartenders work in states that prohibit employers from obtaining tips received by employees.²⁴ In these states, employers must continue complying with state law, and therefore tipped employees in these states may not be impacted by the changes proposed in this NPRM. The potential transfers of tips would depend on employer behavior, employee behavior, customer behavior, and other factors. The Department seeks public comments, which should include supporting data whenever possible, on "tip pooling" practices in workplaces where an employer pays tipped employees a direct cash wage that is equal to or greater than the Federal minimum wage. The Department uses the term "tip pooling" to describe any scenario in which a tip provided by a customer to an employee or group of employees is redistributed, in whole or in part, with other employees.²⁵ The

Department recognizes that in some workplaces or under State laws, the term "tip pooling" may refer to a narrower set of practices, and that employers and workers may use other terms—for example "tip out," "tip sharing," or "tip jar"—to describe certain practices regarding tips. Accordingly, the Department asks commenters to define in their comments any terms they use to describe practices regarding tips. Specifically, the Department solicits comments with supporting data to the following issues:

1. Among employers that currently pay a direct cash wage of at least the Federal minimum wage and do not take a tip credit, what portion reallocate tips, with other employees? And, among that population of employers, what portion of the total tips do they retain or reallocate?

2. How prevalent are employer-required, or mandatory, tip pools? What factors determine whether an employer institutes a mandatory tip pool? What portion of the tips received by employees do employers anticipate being contributed to the tip pool? What kinds of factors might influence an employer's decision to exclude some tips from inclusion in a mandatory tip pool?

3. Do tipped employees receiving money from a mandatory tip pool typically receive a fixed dollar amount, or a fixed percentage of the pool? Is it common for some employees to receive

contribute a portion of her tips to a tip pool, but only if the pool is limited to "employees who customarily and regularly receive tips." Public Law 93-259, 13(e), (*i.e.*, a "valid tip pool"). See § 531.54; Field Operations Handbook 30d04(a).

²² An establishment is commonly understood as a single economic unit, such as a farm, a mine, a factory, or a store, that produces goods or services. Establishments are typically at one physical location and engaged in one, or predominantly one, type of economic activity for which a single industrial classification may be applied. An establishment is in contrast to a firm, or a company, which is a business and may consist of one or more establishments, where each establishment may participate in a different predominant economic activity. See Quarterly Census of Employment and Wages: Concepts, <https://www.bls.gov/opub/hom/cew/concepts.htm>.

²³ Under the Department's proposed rule, employers that do take a tip credit will still be subject to section 3(m)'s restrictions on the use of employee tips.

²⁴ See, e.g., Cal. Labor Code § 351 ("Every gratuity is hereby declared to be the sole property of the employee or employees to whom it was paid, given, or left for."); N.Y. Lab. Law § 196-d ("No employer . . . 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."). The Department seeks comments regarding how certain state laws apply to the retention of tips when the employer pays the full minimum wage directly and does not take a tip credit. Such information may assist the Department in providing a more detailed analysis in the final rule.

²⁵ Under the Department's current regulations, an employer can lawfully mandate that an employee

a larger share of the tip pool than others,²⁶ or are tips typically distributed on an even basis among all participants in the tip pool?

4. If this proposed rule were adopted as proposed, what kinds of employees would employers choose to include in mandatory tip pools?

5. If this proposed rule were adopted as proposed, would customers' tipping practices change?

6. If this proposed rule were adopted as proposed, would some employers respond by reallocating tipped income to their non-tipped employees? Would such a response reduce the disparity in take-home earnings between tipped and non-tipped employees in service industry establishments?

7. If this rule were adopted as proposed, what non-regulatory limitations would employers and employees face when deciding whether and how to design a tip pooling arrangement? Are there any market norms or other behavioral reasons why some types of tip pooling are more prevalent than others? To what extent is the endowment effect (that is, customarily and regularly tipped employees potentially valuing tips more than wages of the same average amount) relevant for explaining potential tip behavior in a relatively less-regulated market?

iv. Estimated Costs and Cost Savings to Employers

In this subsection, the Department addresses regulatory familiarization costs and recordkeeping costs and cost savings attributable to the proposed rule. The Department also presents a qualitative discussion of potential benefits and the impacts of the proposed rule on wages and employment, as well as possible changes to customers' tipping behavior resulting from employers reallocating tips to other employees.

1. Regulatory Familiarization Costs

Regulatory familiarization costs represent direct costs on businesses associated with reviewing the new regulation. It is not clear whether regulatory familiarization costs are a function of the number of establishments or the number of firms. It can be assumed that the headquarters of a firm will conduct the regulatory review for businesses with multiple restaurants, and may also require chain restaurants to familiarize themselves with the regulation at the establishment level. To be conservative, the Department used the number of establishments in its cost estimate—which is larger than the number of firms—and assumes that regulatory

familiarization occurs both the headquarters and at the decentralized (*i.e.*, establishment) level.

The Department assumes that all establishments will incur some regulatory familiarization costs regardless of whether the employer decides to change its tip practices as a result of the proposed rule. There may be differences in familiarization cost by the size of establishments; however, our analysis does not compute different costs for establishments of different sizes. The estimate of regulatory familiarization cost in the analysis is assumed to be conservative. Further, the change in this regulation is quite straightforward and is unlikely to have a major burden or cost.

To estimate the total regulatory familiarization costs, the Department used: (1) The number of establishments in the two industries, Drinking Places (Alcoholic Beverages) and Full-service Restaurants, employing affected workers; (2) the wage rate for the employees reviewing the rule; and (3) the number of hours that it estimates employees will spend reviewing the rule. Table 2 shows the number of establishments in the two industries. To estimate the number of affected establishments, the Department used data from BLS's QCEW.

TABLE 2—NUMBER OF ESTABLISHMENTS WITH TIPPED WORKERS, 2016

Industry	Establishments
NAICS 722410 (Drinking Places (Alcoholic Beverages))	43,152
NAICS 722511 (Full-service Restaurants)	238,776
Total	281,928

Source: QCEW, 2016.

For familiarization cost analysis, the Department assumes that a Compensation/benefits specialist (SOC 13–1141) (or a staff member in a similar position) with a median wage of \$29.85 per hour in 2016 will review the rule.²⁷ Given the change proposed, the Department assumes that it will take about 15 minutes to review the final rule. Assuming benefits are paid at a rate of 46 percent of the base wage, and overhead costs are 17 percent of the base wage, the reviewer's effective hourly rate is \$48.66; thus, the average

cost per establishment is \$12.17 for 15 minutes of review time. The number of establishments in the selected industries was 281,928 in 2016. Therefore, regulatory familiarization costs in Year 1 are estimated to be \$3.431 million (\$12.17 × 281,928 establishments), which amounts to a 10-year annualized cost of \$390,510 at a discount rate of 3 percent or \$456,548 at a discount rate of 7 percent.²⁸ Regulatory familiarization costs in future years are assumed to be *de minimis*.

2. Other Potential Costs or Cost Savings

If employers that are currently taking the section 3(m) tip credit continue to do so, their recordkeeping responsibilities under the FLSA regulation, 29 CFR 516.28, would not change under the proposed rule. However, if employers decide to pay the full FLSA minimum wage in cash and do not take a section 3(m) tip credit, they may have cost savings, because they will no longer need to keep the specific records required under 29 CFR 516.28.

²⁶ *Woody Woo*, 596 F.3d 577, addressed the legality of a tip pool where between 55 to 70 percent of the tip pool went to kitchen staff (*e.g.*, dishwashers and cooks), with the remaining 30 to 45 percent returned to servers in proportion to their hours worked. *Id.* at 578–79.

²⁷ Compensation/benefits specialist ensures company compliance with federal and state laws,

including reporting requirements; evaluates job positions, determining classification, exempt or non-exempt status, and salary; plans, develops, evaluates, improves, and communicates methods and techniques for selecting, promoting, compensating, evaluating, and training workers. 13–1141 Compensation, Benefits, and Job Analysis

Specialists, <https://www.bls.gov/oes/current/oes131141.htm> (last visited on July 20, 2017).

²⁸ This regulatory familiarization cost cannot be subtracted from any current compliance costs because there was no Regulatory Impact Analysis in the 2011 rule. Costs incurred in 2011 are sunk from the perspective of employers in 2017.

To the extent that some employers choose to change their practices and pay at least the full FLSA minimum wage in cash and not take a section 3(m) tip credit, they may have to revise their employee handbooks, adjust their payroll systems, and/or advise affected employees. These are generally regarded as adjustment costs that would be imposed by changes in the regulations. The Department recognizes, however, that deciding to pay at least the full

FLSA minimum wage in cash and not take a section 3(m) tip credit is a choice some employers may make in responding to the proposed rule, but is not a requirement of the regulation. Due to the many variables and assumptions needed to estimate how employers will respond to the proposed regulatory changes and insufficient information at this time regarding the costs that employers may assume or not incur as a result of the proposed rule, the

Department has not quantified a monetary value for any additional costs or cost savings in this NPRM. The Department invites comments regarding any potential costs or cost savings attributable to the proposed rule.

v. Summary of Familiarization Costs

Below the Department provides a summary table of the quantified costs for the RIA.

TABLE 3—REGULATORY FAMILIARIZATION COSTS

	Disc rate = 3%	Disc rate = 7%
First Year Costs (\$ million)	\$3.431	\$3.431
10-year Annualized Costs (\$)	390,510	456,548

C. Discussion of Benefits and Other Potential Impacts of the Proposed Rule

i. Benefits

The purpose of section 3(m)'s tip credit provision is to allow an employer to subsidize a portion of its Federal minimum wage obligation through a credit against the tips given to employees by customers. If an employer takes a tip credit against its wage obligations, section 3(m) applies, along with its attendant provisions that restrict the employer's use of tips received by employees, including the requirement that only tipped employees be included in the tip pool. However, where an employer has paid employees a direct cash wage of at least the full Federal minimum wage, the proposed rule would allow the employer to reallocate tips received by its employees in a manner currently prohibited by regulation, including distributing tips to non-tipped employees (e.g., cooks or dishwashers) through a tip pool. The proposed rule, therefore, provides employers greater flexibility in determining the pay policies for tipped and non-tipped workers. Theoretically, it additionally allows them to reduce wage disparities among employees who all contribute to the customers' experience and incentivize all employees to improve that experience regardless of position.

It is common in full-service restaurants to have a tip pool. One study suggests that tip pooling contributes to increased service quality, along with enhanced interaction and cooperation between coworkers, especially when team members rely on input or task completion from each other.²⁹ From

management's perspective, tip pooling may foster service that is customer-focused and promotes a setting where employees get along well, and may increase productivity.³⁰ These studies suggest that expanding the tip pool to include non-tipped employees may lead to enhanced interaction and cooperation between coworkers, and increased quality of service. On the other hand, a recent meta-analysis indicates that tips may be more a function of server looks and friendliness, the customer's mood, and even the weather than they are of aspects of service quality that depend on cooks, dishwashers, or other back-of-house staff who might newly be included in tip pools as a result of this proposed policy.³¹ Under the proposed changes, the employer will be able to distribute customer tips to non-tipped employees, possibly resulting in increased earnings for those employees.

Also, research demonstrates a negative correlation between earnings and employee turnover: As earnings increase, employee turnover decreases.³² If earnings increase for previously non-tipped employees who are newly added to a tip pool (or tip pools), then employers may see a decreased turnover rate amongst these

employees. Reducing turnover may increase productivity, at least partially, because new employees have less firm-specific capital (i.e., skills and knowledge that have productive value in only one particular company) and thus are less productive and require additional supervision and training. Replacing experienced workers with new workers decreases productivity in the short term; avoiding the need to replace experienced workers may, thus, increase productivity. Reduced turnover should also reduce firms' hiring and training costs, leading to increased profitability. Although there may be increased turnover among tipped employees who would lose a portion of the tips they currently receive, thus leading to effects that are opposite in direction to the previously-discussed impacts, employers are best positioned to consider those issues and determine the optimum distribution of tipped income among their staff for the purpose of reducing employee turnover.

To the extent employers overall decrease use of the tip credit for traditionally tipped employees because of this proposed rule change, that too may provide benefits to traditionally tipped employees. A guaranteed direct cash wage of at least the full federal minimum wage will improve traditionally tipped employees' participation in various aspects of the marketplace that irregular income from changes over time from tip income may impact adversely. As with the previous paragraph, the benefits to one subset of employees (in this case, those who were previously paid a lower direct wage and received tips and now receive an increased direct wage payment from the employer) may be accompanied by harm to another subset (those who newly receive tips while experiencing an offsetting wage reduction).

²⁹ Samuel Estreicher and Jonathan Nash, American Law & Economics Association Annual Meetings, *The Law and Economics of Tipping: The*

Laborer's Perspective. (2004) available at <http://law.bepress.com/alea/14th/art54>.

³⁰ Ofer H. Azar, *The implications of tipping for economics and management*, 30 (10) International Journal of Social Economics. 1084–1094 (2003).

³¹ Michael Lynn and Michael McCall, *Beyond Gratitude and Gratuity: A Meta-Analytic Review of the Predictors of Restaurant Tipping*, Cornell University Working Paper (2016), available at <http://scholarship.sha.cornell.edu/cgi/viewcontent.cgi?article=1021&context=workingpapers>.

³² Rodger W. Griffith, Peter W. Hom, and Stefan Gaertner, *A Meta-Analysis of Antecedents and Correlates of Employee Turnover: Update, Moderator Tests, and Research Implications for the Next Millennium*, 26 (3) Journal of Management. 463–488 (2000).

To the extent employers may otherwise make an arrangement to allocate any customer tips to make capital improvements to their establishments (e.g., enlarging the dining area to accommodate more customers), lower restaurant menu prices, provide new benefits to workers (e.g., paid time off), increase work hours, or hire additional workers, these are also potential benefits to employees and the economy overall that may result under the proposed rule. The rule's transfer impacts could be approached with a model of minimum wages being made less binding by the proposed policy; as such, employment in the affected industries and occupations would, on net, be expected to increase. While some baseline workers could be harmed, due to lower overall compensation, both employers and workers who would lack jobs in the relevant occupations in the absence of the rule would experience benefits. Analysis of reduced deadweight loss would be a standard method for quantifying the gains to society of increased employment resulting from a policy such as the one proposed in this NPRM.

Finally, the proposed rule may result in a reduction in litigation. As explained in Part II, above, there has been a significant amount of private litigation in recent years involving the tip pooling and tip retention practices of employers that pay a direct cash wage of at least the Federal minimum wage. Much of that litigation involves the application of the Department's 2011 tip credit regulations providing that an employer's ability to utilize tips received by its employees is restricted even when it has not taken a tip credit. In several cases, employees alleged that their employers, who had paid their tipped employees a direct cash wage of at least the Federal minimum wage, improperly retained some or all of the tips received by employees or mandated that they participate in a tip pool that included non-tipped employees. The proposed rule rescinds those portions of the 2011 regulations that restrict employer use of customer tips when the employer pays at least the full Federal minimum wage and does not claim a section 3(m) tip credit, likely reducing litigation in this area.

ii. Additional Discussions

Reallocation of tips may have implications on employment and earnings, as well as some impact on the tipping behavior of customers. Due to data limitations, it is difficult to quantify these impacts. Accordingly, in this section, the Department provides a

qualitative discussion of the possible impacts of the proposed rule on employment and earnings and customer tipping behavior.

1. Possible Employment and Earnings Impacts of the Transfer of Tips

Research on how changes in the minimum required cash wage for tipped employees affect their earnings and employment is scarce, making the effects of these policies difficult to gauge. There is need for more research as tipped employment has been growing considerably. From 1990 to 2016 private sector employment grew by 31.8 percent, while employment in full service restaurants grew by 75 percent.³³

Intuitively, the effect of this proposed rule will be driven by many economic factors, such as the prevailing wages in the local area, the supply and demand elasticity for labor in the local markets, and the demand elasticity for the restaurant's product. For instance, in a given market, if the equilibrium cash wage for tipped employees is above the minimum required cash wage, an employer has less incentive to change its behavior as a result of the changes proposed in the NPRM. Given that the firm is in a perfectly competitive market, any deviation from the market wage may cause the firm to lose its staff. However, if the conditions in the market are such that the equilibrium cash wage for tipped workers is below the minimum required cash wage, and a worker earns sufficient tips that their cash wage plus the tips that they receive is equal to or greater than the applicable full minimum wage, then their employer may have an incentive to increase the wage to the applicable minimum wage and share the tips that tipped employees receive with, for instance, other lower-wage non-tipped employees. In such a case, an increase in the direct cash wage paid to the tipped workers and the transfer of tips from workers to others can be associated with changes in employment. If the employees' new wage is lower than their prior wage plus tips, and if the tips received by employees are not being redistributed to them, then there may be a decline in the quantity of supplied labor of tipped workers, and therefore in their employment. Alternatively, the employer could effectively redistribute tips to other employees and thus reduce its overall wage bill. If it now requires less direct wages to hire their workers,

³³ See Bureau of Labor Statistics, Current Employment Statistics, www.bls.gov/ces. The implicit assumption is that the proportion of tipped workers in these industries remained constant over time, which then implies that there was an increase in tipped employment.

it may increase the employer's demand for labor.^{34 35}

However, for reasons such as "sticky wages"³⁶ in the short run and inflexibility in substituting between labor and capital, the above discussion of the potential effect on employment and wages in this analysis may be only valid in the medium to long run. Further, the overall consequences of this proposed rule on employment and earnings will be driven by the employers' response to this rule; i.e., whether establishments continue taking the tip credit, and what proportion of employers switch from taking the tip credit to not taking the tip credit.

2. Possible Change in Customers' Tipping Behavior That Could Result From the Transfer of Tips From Employees to Employers

In the United States, tipping is a common practice in the eating and drinking places industries. The main reasons that a customer would tip are future service, social norms and fairness, and quality of service.³⁷ The theoretical economic justification for tipping is that it incentivizes and rewards good service.³⁸ From the employer's standpoint, tipping may also be considered an efficient way of monitoring the efforts of service workers, and a screening device for identifying good and motivated workers.³⁹

Although consideration of future service is a commonly-stated reason for tipping, evidence suggests that customers do not necessarily regard future service as the main reason for tipping. Even non-repeat customers tip. This leads to the other main cited reason for tipping: Social norms surrounding tipping. Tipping may be the result of a positive utility from feeling generous. In addition, customers often feel empathy for the workers who serve them, and they want to show their

³⁴ Daniel Hamermesh, *Econometric Studies of Labor Demand and Their Application to Policy Analysis*. The Journal of Human Resources, vol. 11, no. 4, 1976, pp. 507–525. JSTOR, www.jstor.org/stable/145429.

³⁵ Deadweight loss analysis, discussed elsewhere in this regulatory impact analysis, can be used to assess net effects where isolated partial views of the market seem to indicate opposing tendencies.

³⁶ "Sticky wages" refers to the situation in which workers' wages do not adjust quickly to changes in the overall economy.

³⁷ Ofer H. Azar, *The implications of tipping for economics and management*, 30 (10) International Journal of Social Economics. 1084–1094 (2003).

³⁸ Samuel Estreicher and Jonathan R. Nash, *The Law and Economics of Tipping: The Laborer's Perspective*, American Law & Economics Association Annual Meetings. 54 (2004).

³⁹ Ofer H. Azar, *Optimal monitoring with external incentives: the case of tipping*, Southern Economic Journal. 170–181 (2004).

gratitude by leaving a tip. Customers may also tip as they believe that bartenders, waiters, waitresses, and other workers earn too little for their hard work and therefore want to reward them. Moreover, customers often feel obligated to tip because tips are a major source of income for the workers.^{40 41}

From the employer's standpoint, the theoretical economic justification for tipping is that it incentivizes and rewards good service; In other words, if workers who provide good service earn large tips, they are more likely to retain their jobs, whereas those workers who earn smaller tips are more likely to choose to quit. Tipping can also be a way of monitoring the efforts of service workers. Firms find it difficult and expensive to monitor and control the quality of intangible and highly customized services that are rendered by their employees. Therefore, tipping can allow customers to directly monitor service providers at lower cost than if employers had to directly monitor their employees.⁴²

The potential impact of the proposed rule on customers' decisions to leave tips for bartenders and servers may depend on how much information the customer has regarding the employer's tip pooling policy. Assuming customers are aware of the employer's policy, changes to tipping behavior, if they occur at all, may differ depending on whether the tips are redistributed into a tip pool that includes a broader group of employees, or otherwise utilized in part (or in full) by the employer. Tipping may also be affected if the change is not welcomed by the staff, leading to poor morale and reduced service quality.

D. Analysis of Regulatory Alternatives

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. The Department considered two alternatives as part of determining whether to issue this NPRM: (1) Making no regulatory changes; and (2) Removing the regulatory language that addresses an

employers' ability to utilize employee tips even when the employer claims a section 3(m) tip credit. The alternatives are discussed in more detail below.

i. Alternative 1

Under the proposed rule, employers would no longer be prohibited from utilizing tips received by employees more broadly so long as they pay at least the full Federal minimum wage in cash and do not claim a section 3(m) tip credit.

For the first alternative, the Department would make no regulatory changes and leave in place the limited nonenforcement policy it announced in July 2013. In *Oregon Restaurant and Lodging Association v. Solis*, 948 F. Supp. 2d 1217 (D. Or. 2013), the U.S. District Court for the District of Oregon declared invalid the Department's 2011 regulations that limit an employer's use of its employees' tips when the employer has not taken a tip credit against its minimum wage obligations, and imposed injunctive relief. As discussed above, on February 23, 2016, the Court of Appeals for the Ninth Circuit reversed the judgment entered by the district court. See *Oregon Restaurant and Lodging Ass'n et al. v. Perez*, 816 F.3d 1080 (2016), *pet. for reh'g and reh'g en banc denied* 843 F.3d 355 (Sept. 6, 2016). Notwithstanding the Ninth Circuit's decision, the Department continues to be constrained by the injunctive relief entered by the district court until the Ninth Circuit issues its mandate, which formally notifies the district court of the court of appeals' decision. On September 13, 2016, the Ninth Circuit issued a Stay of the Mandate "until final disposition [of this litigation] by the Supreme Court." *Oregon Restaurant and Lodging Ass'n et al. v. Perez*, No. 13–35765 (9th Cir., Sept. 13, 2016). For these reasons, the Department is currently prohibited from enforcing its tip retention requirements against the Oregon Restaurant and Lodging Association plaintiffs (which include several associations, one restaurant, and one individual) and members of the plaintiff associations that can demonstrate that they were a member on June 24, 2013. As a matter of enforcement policy, the Department decided at the time the injunction was issued that while the injunction is in place it would not enforce its tip retention requirements against any employer within the Ninth Circuit's jurisdiction that has not taken a tip credit.⁴³ The Ninth Circuit has appellate

jurisdiction over the states of California, Nevada, Washington, Oregon, Alaska, Idaho, Montana, Hawaii, and Arizona; Guam; and the Northern Mariana Islands. The injunction itself does not prevent the Department from investigating cases that are outside the scope of that limited injunctive relief. For instance, the Department can lawfully investigate such cases involving employers located outside the Ninth Circuit and that are not members of the plaintiff associations involved in the ORLA litigation. Making the Department's limited nonenforcement policy permanent without issuing the NPRM, however, would result in different requirements for different geographic regions, or different employers depending on their membership in certain associations. Such a situation, for example, could mean an employer that has locations within, and outside of, the Ninth Circuit would have different compliance requirements. Also, the limited nonenforcement policy does not impact employees' right to bring private actions under section 16(b) of the FLSA to enforce the tip retention regulations, exposing employers to an uncertain landscape. See 29 U.S.C. 216(b). Moreover, taking no regulatory action does not address the Department's concerns discussed above. See, *supra*, Need for Rulemaking.

ii. Alternative 2

For the second alternative, the Department considered removing the regulatory language that reiterates the statutory restrictions in section 3(m) addressing an employer's ability to utilize tips received by employees even when the employer claims a tip credit. The regulations from which the Department considered removing this language include 29 CFR 531.52, 531.54, and 531.59. Under this alternative, for employers that claim a tip credit, the Department would enforce the tip retention requirements of section 3(m) based only on the text of the statute.

There is a significant risk, however, that this alternative would create confusion as to tipped employees' right to retain tips when their employer claims a tip credit. The removal of the Department's current regulatory guidance could also increase the risk of employer non-compliance with the statute due to the lack of regulatory guidance.

nonenforcement position when it decided to pursue this rulemaking.

⁴⁰ William E. Even and David A. Macpherson, *The effect of the tipped minimum wage on employees in the US restaurant industry*, 80(3) Southern Economic Journal. 633–655 (2014).

⁴¹ PayScale's Restaurant Report: The Agony and Ecstasy of Food Service Workers, <http://www.payscale.com/data-packages/restaurant-report/full-data>.

⁴² Ofer H. Azar, *Optimal Monitoring with External Incentives: The Case of Tipping*, Southern Economic Journal 170–181 (2004).

⁴³ As noted in section II and footnote 6, the Department expanded the scope of this initial

E. Classification as a Deregulatory Action and Estimated Regulatory Cost Savings

Under the current regulations, employers are prohibited from reallocating tips or including non-tipped employees in a mandatory tip pool “whether or not the employer has taken a tip credit under section 3(m) of the FLSA.” 29 CFR 531.52. This proposed rule would remove such restrictions on the treatment of tips when an employer does not take a tip credit, and would not introduce any new regulatory requirements in replacement of the requirements proposed for elimination. Therefore, it is expected that this proposed rule would, if finalized as proposed, qualify as a “deregulatory action” for the purposes of E.O. 13771.

As discussed earlier, the Department estimates that this proposed rule would result in Year 1 regulatory familiarization costs of approximately \$3.4 million. *See, supra*, Section VII.B.v. The Department expects that these relatively modest familiarization costs would be more than offset by greater cost savings for employers attributable to the elimination of existing regulatory requirements, but, due to a lack of adequate information about the costs employers presently bear in complying with the regulations identified for elimination, cost savings have not been quantified in this Notice of Proposed Rulemaking. Additionally, the Department notes that reduced deadweight loss in the affected labor markets would likely significantly outweigh the \$3.4 million in estimated regulatory familiarization costs.

VIII. Initial Regulatory Flexibility Analysis (IRFA)

The Regulatory Flexibility Act of 1980 (RFA), 5 U.S.C. 601 *et seq.*, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996, Public Law 104–121 (March 29, 1996), requires federal agencies engaged in rulemaking to consider the impact of their proposals on small entities, consider alternatives to minimize that impact, and solicit public comment on their analyses. The RFA requires the assessment of the impact of a regulation on a wide range of small entities, including small businesses, not-for-profit organizations, and small governmental jurisdictions.

Agencies must perform a review to determine whether a proposed or final rule would have a significant economic impact on a substantial number of small entities. 5 U.S.C. 603 and 604. As part of a regulatory proposal, the RFA

requires a federal agency to prepare, and make available for public comment, an initial regulatory flexibility analysis that describes the impact of the proposed rule on small entities. 5 U.S.C. 603(a).

The Department has conducted, and is publishing here, an initial regulatory flexibility analysis to help small entities better understand the impacts of the proposed rule. The Department invites comments on the number of small entities affected by the proposed rule’s requirements, the compliance cost estimates, and whether alternatives exist that will reduce the burden on small entities.

A. Why the Department Is Considering Action

As explained in greater detail earlier in the analysis, the Department has serious concerns that it incorrectly construed the statute in promulgating its current tip regulations to apply to employers that have paid a direct cash wage of at least the full Federal minimum wage to their tipped employees and serious concerns about those regulations as a policy matter. The Department is therefore proposing to rescind those portions of its tip regulations at 29 CFR part 531, subpart D that impose restrictions on employers that pay a direct cash wage of at least the full Federal minimum wage and do not claim a tip credit against their minimum wage obligations.

B. Statement of Objectives and Legal Basis for the Proposed Rule

The Department’s regulations addressing the treatment of tipped employees under federal law at 29 CFR part 531, subpart D are derived from section 3(m) of the FLSA. *See* 29 U.S.C. 203(m). As explained earlier, the Department now has serious concerns that it incorrectly construed the statute in promulgating its current tip regulations to apply to employers that do not take a tip credit, *i.e.*, where an employee receives at least the full \$7.25 Federal minimum wage directly from the employer, and serious concerns about the regulations as a policy matter, especially in light of changed circumstances.

The purpose of Section 3(m)’s tip credit provision is to allow an employer to subsidize a portion of its Federal minimum wage obligation through a credit against the tips given to employees by customers. If an employer pays its tipped employees a direct cash wage of at least the full Federal minimum wage (currently \$7.25 per hour) but reallocates equal or greater amount of the tips received by its employees, there is a question as to

whether the employer is circumventing the protections of Section 3(m) because it is utilizing tips received by its employees towards its minimum wage obligations to a greater extent than permitted under the statute. Where, however, an employer has paid employees a direct cash wage of at least the full Federal minimum wage and does not reallocate the employee tips directly, but requires that employee tips be distributed to non-tipped employees through a tip pool, there is a strong argument that the statutory protections of Section 3(m) are not circumvented.

C. Description of the Number of Small Entities to Which the Proposed Rule Will Apply

This section describes the industry or economic sector that will be affected by the proposed rule in total and its small and large entity segments, includes a description of the industry or sector at the time of the proposal, and explains any existing dynamics, such as trends in employment or birth of entities.

i. Definition of a Small Entity

A “small entity” is one that is “independently owned and operated and which is not dominant in its field of operation.”⁴⁴ The definition of “small business” varies from industry to industry to properly reflect industry size differences. An agency must either use the Small Business Administration (SBA) definition for a small entity or establish an alternative definition for the relevant industries to which a rule applies.

In our analysis, the Department uses the Small Business Administration (SBA) size standards, which determine when a business qualifies for small business status.⁴⁵ According to the 2017 standards, Full-service Restaurants (NAICS 722511) and Drinking Places (Alcoholic Beverages) (NAICS 722410) have a size standard of \$7.5 million in annual revenue.⁴⁶ The Department used this number to estimate the number of small entities in this analysis. Any firms with annual sales revenue less than this

⁴⁴ The RFA adopts the definition of “small business concern” used in the Small Business Act, 15 U.S.C. 632(a)(1).

⁴⁵ U.S. Small Business Administration, Summary of Size Standards by Industry Sector, February 2016. Retrieved June 21, 2017 from <https://www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/summary-size-standards-industry-sector>. *See also* full US SBA Size Standard listings at <https://www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/table-small-business-size-standards>.

⁴⁶ *Id.*, Subsector 722.

amount will be considered a small business entity in this analysis.

ii. Data Sources and Methods

The Department used data from several different sources to estimate the number of small entities to which the rule will apply, *i.e.*, affected firms. The Department used the U.S. Census Bureau, 2012 Economic Census⁴⁷ to obtain the number of firms, total number of paid employees, and annual sales/receipts for the two industries in the analysis: Full-service Restaurants (NAICS 722511) and Drinking Places (Alcoholic Beverages) (NAICS 722410).

From annual receipts/sales, the Department can estimate how many firms fall under the size standard. Table 4 below shows the number of private firms in the two industries by revenue. The *number of firms and number of employees* are obtained directly from the U.S. Economic Census (2012) data.⁴⁸

To obtain the *number of bartenders & waiters/waitresses* in the two industries, the Department used the BLS industry-occupation mix (2014).⁴⁹ Using the staffing mix of industries to estimate bartenders and wait staff allows for use of the very latest industry data, which builds on the highly-regarded QCEW data set. About 42.9 percent of workers in the Full-service Restaurant industry (NAICS 722511) are bartenders or waiters/waitresses (5 percent are bartenders; 37.9 percent are waiters/waitresses). In Drinking Places (Alcoholic Beverages) (722410), about 63.5 percent are bartenders and waiters/waitresses (46.1 percent are bartenders; 17.4 percent are waiters/waitresses). The Department applied these percentages uniformly to total paid employees in these two industries to obtain the number of bartenders and waiters/waitresses across all firm sizes.

To determine the number of tipped bartenders & waiters/waitresses, the Department used 57 percent of all bartenders and waiters/waitresses in both industries, based on the share in the CPS data that report usually receiving tips.⁵⁰

The annual cost per firm is calculated based on the regulatory familiarization cost (\$3.4 million), which amounts to \$12.17 per establishment. The Department applied this cost to all sizes of firms since this will be incurred by each firm regardless of the number of affected workers. Finally, the impact of this provision is calculated as the ratio of annual cost per firm to receipts per firm. As shown, the per-firm cost incurred in the first year (\$12.17) is less than one percent of annual receipts per small firm under this proposed rule; thus, it does not have any significant burden on small entities.

TABLE 4—ANNUAL COST TO SMALL ENTITIES

Annual revenue/sales/receipts (2012)	Number of firms	Number of paid employees	Average annual sales per firm (\$)	Number of bartenders and servers ^a	Number of tipped bartenders and servers	Annual cost per firm (\$) ^b	Annual cost per firm as percent of sales/receipts
Firms with revenue less than \$100,000	10,071	24,455	\$61,885	10,491	5,246	\$12.17	Less than 0.1%.
Firms with revenue of \$100,000 to \$249,999	28,344	129,413	175,461	55,518	27,759	12.17	Less than 0.1%.
Firms with revenue of \$250,000 to \$499,999	38,105	324,566	366,027	139,239	69,620	12.17	Less than 0.1%.
Firms with revenue of \$500,000 to \$999,999	40,970	652,792	714,479	280,048	140,024	12.17	Less than 0.1%.
Firms with revenue of \$1,000,000 to \$2,499,999	32,965	1,066,544	1,514,178	457,547	228,774	12.17	Less than 0.1%.
Firms with revenue of \$2,500,000 to \$4,999,999	7,806	499,989	3,330,922	214,495	107,248	12.17	Less than 0.1%.
Firms with revenue of \$5,000,000 to \$9,999,999	2,021	237,316	6,653,982	101,809	50,905	12.17	Less than 0.1%.
Firms with revenue less than \$100,000	4,584	N/A	—	—	—	12.17	
Firms with revenue of \$100,000 to \$249,999	11,517	44,508	171,075	28,263	14,132	12.17	Less than 0.1%.
Firms with revenue of \$250,000 to \$499,999	8,873	60,159	350,496	38,201	19,101	12.17	Less than 0.1%.
Firms with revenue of \$500,000 to \$999,999	5,029	65,124	689,494	41,354	20,677	12.17	Less than 0.1%.
Firms with revenue of \$1,000,000 to \$2,499,999	3,046	82,871	1,492,272	52,623	26,312	12.17	Less than 0.1%.
Firms with revenue of \$2,500,000 to \$4,999,999	668	36,013	3,370,838	22,868	11,434	12.17	Less than 0.1%.
Firms with revenue of \$5,000,000 to \$9,999,999	156	13,785	6,740,077	8,753	4,377	12.17	Less than 0.1%.

^a "Servers" stands for waiters & waitresses; 'N/A' Not available in Economic census, 2012, withheld to avoid disclosing data for individual companies; data are included in higher level totals; '-' value not calculated as one or more inputs are missing.
^b The Annual Cost per firm is the regulatory familiarization cost per firm calculated in Section VII.B.iv.i.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule

The FLSA sets minimum wage, overtime pay, and recordkeeping requirements for employment subject to its provisions. The FLSA allows an employer to claim a tip credit, as defined by section 3(m) of the statute, toward meeting its minimum wage obligation for employees who customarily and regularly receive more than \$30.00 per month in tips. FLSA section 11(c) requires all covered

employers to make, keep, and preserve records of employees and of wages, hours, and other conditions of employment. Employers use the records to document compliance with the FLSA, including showing the tips received is not less than the tip credit claimed. The Department has promulgated regulations at 29 CFR part 516 to establish the basic FLSA recordkeeping requirements; this proposal does not alter these recordkeeping requirements. The recordkeeping regulation at 29 CFR 516.28 applies to tipped employees.

Since the employees who may be impacted by the proposed changes to the regulations are those for whom the employer pays a direct cash wage of at least the FLSA minimum wage under section 6(a)(1)(C) with no tip credit taken, such employers would not face additional recordkeeping requirements within the scope of 29 CFR 516.28. Therefore, there are no additional recordkeeping requirements beyond those required by other sections of the FLSA under the proposed rule. Similarly, the proposed rule does not

⁴⁷ U.S. Census Bureau, 2012 Economic Census https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ECN_2012_US_72SSZ1&prodType=table.

⁴⁸ The small business size standard for the two industries is \$7.5 million in annual revenue. However, the final size category reported in the table is \$5 million–\$9 million. This is a data

limitation because the 2012 Economic Census reported this category of \$5 million–\$9 million and not \$5 million–\$7.5 million. Thus, the total number of firms used in the calculation may be slightly higher.

⁴⁹ BLS Industry-Occupation Matrix Data, By Industry, https://www.bls.gov/emp/ep_table_109.htm.

⁵⁰ As noted above, *see, supra*, section VII.B.ii, approximately 57 percent of waiters/waitresses and bartenders in the 2016 CPS–MORG survey responded affirmatively when asked if they usually receive tips or commissions. The Department considers employees who responded affirmatively to this question to be tipped employees.

have reporting or other compliance requirements.

i. Costs to Small Entities

The direct costs to employers, specifically, regulatory familiarization, are quantified in the Regulatory Impact Analysis. Regulatory familiarization costs are the costs incurred to read and become familiar with the requirements of the rule. Regardless of business size, the Department estimates that each establishment will spend 15 minutes for regulatory familiarization. As a direct result of this proposed rule, the Department expects total direct employer costs (regulatory familiarization) of \$2,362,866 will be incurred by all small entities combined in the first year after the promulgation of the proposed rule: \$12.17—the cost of 15 minutes of work by a Compensation/benefits specialist (SOC 13–1141), *see, supra*, VII.B.iv—multiplied by 194,155, the number of small entities (see below). Regulatory familiarization costs are only incurred in the first year. The per-firm costs incurred in the first year (\$12.17) are less than one percent of the annual average revenue per firm for the small entities shown in Table 4 in Section VIII.C.ii.

ii. Number of Small Entities Impacted by the Proposed Rule

As noted above, the SBA size standard for Full-service Restaurants (722511) and Drinking Places (Alcoholic Beverages) (722410) is \$7.5 million in annual revenue.⁵¹ There are 194,155 small entities that fall below this size standard in these two selected industries, which accounts for 78 percent of total number of firms in these industries, employing about 3,237,535 employees. As per the calculation in Section VIII.C, the Department estimates the proposed rule would have no significant negative impact.

E. Regulatory Alternatives That Minimize the Impact on Small Entities

Section 603(c) of the RFA requires that each initial regulatory flexibility analysis contain a description of any significant alternatives to the proposal that accomplish the statutory objectives and minimize the significant economic impact of the proposal on small entities. The Department considered the following alternatives:

i. Differing compliance or reporting requirements that take into account the resources available to small entities. This NPRM makes no changes to

existing recordkeeping and reporting requirements. Accordingly, it is not necessary to establish different compliance or reporting requirements for small businesses.

ii. The clarification, consolidation, or simplification of compliance and reporting requirements for small entities. The proposed rule imposes no new compliance or reporting requirements. The Department makes available a variety of resources to employers for understanding their obligation and for achieving compliance.

iii. The use of performance rather than design standards. Under the proposed rule, employers may achieve compliance through a variety of means. Employers may elect to continue (or not) to take a tip credit under section 3(m) of the FLSA. For those employers who take such a tip credit, the statutory restrictions on employer use of customer tips continue to apply. However, for those employers who pay at least the Federal minimum wage and do not take a section 3(m) tip credit, the proposed rule rescinds those regulatory restrictions. The Department makes available a variety of resources to employers for understanding their obligation and for achieving compliance.

iv. An exemption from coverage of the rule, or any part thereof, for such small entities. Creating an exemption from coverage of the NPRM for small businesses is not necessary as this proposed rule proposes to rescind employer restrictions on employer use of customer tips when the employer pays at least the Federal minimum wage in cash and does not take a section 3(m) tip credit.

F. Differing Compliance and Reporting Requirements for Small Entities

Due to the deregulatory nature of this rulemaking, the Department does not believe that different compliance and reporting requirements for small entities are required.

G. Identification, to the Extent Practicable, of All Relevant Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rule

The Department is not aware of any federal rules that duplicate, overlap, or conflict with this NPRM.

IX. Unfunded Mandates Reform Act Analysis

The Unfunded Mandates Reform Act of 1995 (UMRA), 2 U.S.C. 1532, requires that agencies prepare a written statement, which includes an assessment of anticipated costs and

benefits, before proposing any Federal mandate that may result in excess of \$100 million (adjusted annually for inflation) in expenditures in any one year by state, local, and tribal governments in the aggregate, or by the private sector. This rulemaking is not expected to affect state, local, or tribal governments. While this rulemaking would affect employers in the private sector, it is not expected to result in expenditures greater than \$100 million in any one year. Please see Section VII.B–C for an assessment of anticipated costs and benefits to the private sector.

X. Executive Order 13132, Federalism

The Department has (1) reviewed this proposed rule in accordance with Executive Order 13132 regarding federalism and (2) determined that it does not have federalism implications. The proposed rule would not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

XI. Executive Order 13175, Indian Tribal Governments

This proposed rule would not have substantial direct effects on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

XII. Effects on Families

The undersigned hereby certifies that the proposed rule would not adversely affect the well-being of families, as discussed under section 654 of the Treasury and General Government Appropriations Act, 1999.

XIII. Executive Order 13045, Protection of Children

This proposed rule would have no environmental health risk or safety risk that may disproportionately affect children.

XIV. Environmental Impact Assessment

A review of this proposed rule in accordance with the requirements of the National Environmental Policy Act of 1969 (NEPA), 42 U.S.C. 4321 *et seq.*; the regulations of the Council on Environmental Quality, 40 CFR part 1500 *et seq.*; and the Departmental NEPA procedures, 29 CFR part 11, indicates that the rule would not have a significant impact on the quality of the human environment. There is, thus, no corresponding environmental

⁵¹ Because of the limitations of the size-class data, the analysis looks at firms with annual revenues up to \$9,999,999.

assessment or an environmental impact statement.

XV. Executive Order 13211, Energy Supply

This proposed rule is not subject to Executive Order 13211. It will not have a significant adverse effect on the supply, distribution, or use of energy.

XVI. Executive Order 12630, Constitutionally Protected Property Rights

This proposed rule is not subject to Executive Order 12630 because it does not involve implementation of a policy that has takings implications or that could impose limitations on private property use.

XVII. Executive Order 12988, Civil Justice Reform Analysis

This proposed rule was drafted and reviewed in accordance with Executive Order 12988 and will not unduly burden the Federal court system. The proposed rule was: (1) Reviewed to eliminate drafting errors and ambiguities; (2) written to minimize litigation; and (3) written to provide a clear legal standard for affected conduct and to promote burden reduction.

XVIII. Summary of Proposed Changes

The Department proposes to remove or amend the portions of §§ 531.52, 531.54, and 531.59 that impose restrictions on employers that pay a direct cash wage of least the Federal minimum wage and do not claim the section 3(m) tip credit. The proposed rule deletes the fourth sentence of section 531.52, which currently states that “[t]ips are the property of the employee whether or not the employer has taken a tip credit under section 3(m) of the FLSA.” The proposed rule also revises the fifth sentence of sections 531.52, the last sentence of section 531.54, and the final sentence of section 531.59(b) to remove language placing restrictions on an employer’s use of tips when that employer has not taken a tip credit while retaining language that reflects the statutory restrictions on an employer’s use of tips received by its employees when it does take a tip credit.

List of Subjects in 29 CFR Part 531

Employment, Labor, Minimum wages, Wages.

Bryan L. Jarrett,

Acting Administrator, Wage and Hour Division.

For the reasons set forth above, the Department proposes to amend Title 29,

part 531 of the Code of Federal Regulations as follows:

PART 531—WAGE PAYMENTS UNDER THE FAIR LABOR STANDARDS ACT OF 1938

■ 1. The authority citation for part 531 continues to read as follows:

Authority: Sec. 3(m), 52 Stat. 1060; sec. 2, 75 Stat. 65; sec. 101, 80 Stat. 830; sec. 29(B), 88 Stat. 55, Pub. L. 93–259; Pub. L. 95–151, 29 U.S.C. 203(m) and (t); Pub. L. 104–188, 2105(b); Pub. L. 110–28, 121 Stat. 112.

■ 2. Revise § 531.52 to read as follows:

§ 531.52 General characteristics of “tips.”

A tip is a sum presented by a customer as a gift or gratuity in recognition of some service performed for him. It is to be distinguished from payment of a charge, if any, made for the service. Whether a tip is to be given, and its amount, are matters determined solely by the customer, who has the right to determine who shall be the recipient of the gratuity. An employer that takes a tip credit is prohibited from using an employee’s tips for any reason other than that which is statutorily permitted in section 3(m): As a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool. Only tips actually received by an employee as money belonging to the employee may be counted in determining whether the person is a “tipped employee” within the meaning of the Act and in applying the provisions of section 3(m) which govern wage credits for tips.

* * * * *

■ 3. Revise the last sentence of § 531.54 to read as follows:

§ 531.54 Tip pooling.

* * * However, an employer that takes a tip credit must notify its employees of any required tip pool contribution amount, may only take a tip credit for the amount of tips each employee ultimately receives, and may not retain any of the employees’ tips for any other purpose.

■ 4. In § 531.59, revise the last sentence of paragraph (b) to read as follows:

§ 531.59 The tip wage credit.

* * * * *

(b) * * * With the exception of tips contributed to a valid tip pool as described in § 531.54, the tip credit provisions of section 3(m) also require employers that take a tip credit to permit employees to retain all tips received by the employee.

[FR Doc. 2017–25802 Filed 12–4–17; 8:45 am]

BILLING CODE 4510–27–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket Number USCG–2017–0964]

RIN 1625–AA00

Safety Zone; Oregon Inlet, Dare County, NC

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to establish a temporary safety zone on the navigable waters of Oregon Inlet in Dare County, North Carolina in support of construction of the new Herbert C. Bonner Bridge. This temporary safety zone is intended to protect mariners, vessels, and construction crews from the hazards associated with installing the navigation span, and will restrict vessel traffic from the bridge’s navigation span as it is under construction by preventing vessel traffic on a portion of Oregon Inlet. Entry of vessels or persons into this safety zone is prohibited. We invite your comments on this proposed rulemaking.

DATES: Comments and related material must be received by the Coast Guard on or before December 20, 2017.

ADDRESSES: You may submit comments identified by docket number USCG–2017–0964 using the Federal eRulemaking Portal at <http://www.regulations.gov>. See the “Public Participation and Request for Comments” portion of the **SUPPLEMENTARY INFORMATION** section for further instructions on submitting comments.

FOR FURTHER INFORMATION CONTACT: If you have questions about this proposed rulemaking, contact Petty Officer Matthew Tyson, Waterways Management Division, U.S. Coast Guard Sector North Carolina, Wilmington, NC; telephone: (910) 772–2221, email: Matthew.I.Tyson@uscg.mil.

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
DHS Department of Homeland Security
FR Federal Register
NPRM Notice of proposed rulemaking
§ Section
U.S.C. United States Code
COTP Captain of the Port

II. Background, Purpose, and Legal Basis

On October 10, 2017, the North Carolina Department of Transportation