

Coalition of
Low-Wage and
Immigrant
Worker Advocates

April 15, 2015

Honorable Mayor, Councilmembers and City Attorney
City of Los Angeles
200 N. Spring Street
Los Angeles, CA 90012

Re: Legality of Tip Credits and “Total Compensation” Proposal

Dear Mayor Garcetti, Councilmembers, and City Attorney Feuer:

We write to inform you about the legality of the so-called “total compensation” approach that has recently been suggested for minimum wage legislation for the City. For the reasons explained below, the approach is unlawful under California law.

1. Tip credits and alternative minimum wages for tipped workers are impermissible under State law.

It has long been unlawful in California for an employer to apply amounts a worker receives in tips toward compliance with the employer’s minimum wage obligations. This prohibition stems from California Labor Code Section 351, which provides, in part:

No employer or agent shall collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of a gratuity, or require an employee to credit the amount, or any part thereof, of a gratuity against and as a part of the wages due the employee from the employer. Every gratuity is hereby declared to be the sole property of the employee or employees to whom it was paid, given, or left for.

Cal. Labor Code § 351. The legislative intent of Section 351 is to “ensure that employees, not employers, receive the full benefit of gratuities that patrons intend for the sole benefit of those employees who serve them.” Leighton v. Old Heidelberg Ltd., 219 Cal.App.3d 1062, 1068 (1990).

The California Supreme Court has interpreted Section 351 to bar not only the crediting of tips toward compliance with the minimum wage, but also “two tier” minimum wage systems that enable employers to pay tipped employees less than they would be obligated to pay such workers if they did not receive tips. In Henning v. Industrial Welfare Com., 46 Cal.3d 1263 (1988), the Court struck down an Industrial Wage Commission Order that would have created an “alternative minimum wage” for tipped workers that would be lower than that for other workers. The Court concluded that, under Section 351, as amended, the legislature had prohibited employers

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from taking a “tip credit” to offset their obligation to pay the full minimum wage, and that, “although in form they may be different, in function the ‘tip credit’ and the ‘alternative minimum wage’ are identical.” Id. at 1279.

The Court’s interpretation of Section 351 would apply with equal force were a municipality to attempt to authorize a tip credit or create an alternative minimum wage for tipped workers. Indeed, there is no basis in the Code to suggest that Section 351 limitations, which create a property interest on the part of employees in the tips left for them, would apply any differently to municipalities than they do to state agencies.

We are not alone in reaching this conclusion. In Roberts v. Restaurants Unlimited Inc., Alameda Superior Court Case No. 2002-049644, Judge Steven Brick rejected on demurrer the company’s argument that, where the Berkeley Living Wage Ordinance was unclear, it could credit tips against its wage obligations under the ordinance. In arriving at this result, Judge Brick explained:

Defendant’s alleged conduct in crediting tips against its wage obligations under the [Living Wage Ordinance], if proven, would abridge the property interest created by Labor Code § 351. There is no basis for Defendant’s argument that the scope of § 351 is limited to attempts by an employer to credit tips against the state minimum wage, nor is the policy underlying the statute consistent with this conclusion. (Order re Demurrer to First Amended Complaint, Aug. 5, 2005, at 6.) The case settled with the company agreeing to substantial backpay and no credit going forward.

The City of Berkeley subsequently addressed whether it could, consistent with Section 351, include a tip credit in legislation to enact a city-wide minimum wage. The Berkeley City Attorney advised that a tipped wage would be impermissible under State law. This view was based on a legal analysis by outside counsel, which concluded, in relevant part: “The purpose of the statute is to ensure that employees receive the gratuity given freely and voluntarily to them. We believe that a tipped wage credit against a local minimum wage would violate the purpose as stated by the Legislature and supported by the California Supreme Court.” (City of Berkeley Office of the City Manager, Supplemental Agenda Material, Item B, May 6, 2014, at 2.)

Likewise, in assessing the same question, the City Attorney of San Diego concluded: “Although no court has interpreted how Section 351 may impact a municipality’s ability to enact a minimum wage ordinance, the weight of the legislative history and case law authority suggest that Section 351 likely applies beyond the state minimum wage context and prohibits a local minimum wage with a tip credit.” (Office of the City Attorney of San Diego, Memorandum, “Application of California Labor Code Section 351 To A Local Minimum Wage Ordinance,” July 9, 2014, at 6.)

Of the eight cities in California that have adopted minimum wage laws, none has created a tip credit or alternative minimum wage for tipped workers.

- 2. The “total compensation” proposal would likewise be preempted by State law because it would allow employers to benefit from guest gratuities by paying tipped**

workers less than non-tipped workers.

It has been suggested that the City could avoid Section 351's limitations by adopting what has been called a "total compensation" model. This approach would "require employers to pay a full minimum wage to any employee whose total compensation did not reach the city hourly minimum, but would allow a lower hourly wage to be paid to workers for whom the wage is only a portion of their total compensation." (Letter from Hon. City Council Members Blumenfield, Fuentes, and O'Farrell to Hon. Member Price, Chair of Economic Development Committee, March 24, 2014, at 7.)

This approach would be unlawful under the California Supreme Court's interpretation of Section 351 in Henning. The Court explained in Henning that Section 351's purpose of ensuring that tipped workers obtain the full benefit of their tips would be thwarted were a minimum wage system to allow an employer to pay tipped workers less than the employer pays non-tipped workers:

Broadly, the Legislature has declared that tips belong to the employee and the IWC may not permit an employer to obtain the benefit of such tips by paying a tipped employee a wage lower than he would be obligated to pay if the employee did not receive tips. More narrowly, it has declared that the IWC may not permit an employer to use a "tip credit" to pay a tipped employee a wage lower than the minimum wage he would be obligated to pay if the employee did not receive tips.

Henning, 46 Cal.3d at 1278. The "total compensation" approach would do precisely what Section 351 was intended to prevent: it would allow an employer to benefit from patrons' tips to workers by "paying a tipped worker a wage lower than he would be obligated to pay if the employee did not receive tips." Id.

It has been suggested that the "total compensation" threshold that would trigger the lower minimum wage could be higher than the City's full minimum wage level. However, under the Court's interpretation of Section 351, it makes no difference if a given employee's overall income, including tips, exceeds the City's full minimum wage or some higher threshold. The only relevant question is whether the City's statute would allow the employer to benefit from patrons' tips by paying a tipped employee less than the employer would be required to pay if the employee did not receive tips. Because this would be allowed under the "total compensation" proposal, the proposed scheme is impermissible under Section 351.

The "total compensation" approach is borrowed from Assembly Bill 669. However, AB 669 is not law. Indeed, Assemblymember Tom Daly, the author of the bill, has withdrawn his support for the proposed legislation and removed it from consideration by the Labor Committee. The law of the State remains that Section 351 prohibits minimum wage systems that allow tip credits or alternative minimum wages for tipped employees, including the proposed "total compensation" approach.

For these reasons, legislation incorporating the "total compensation" proposal would be held preempted and unenforceable.

Sincerely,

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