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May 12, 2015

VIA E-MAIL AND FIRST CLASS MAIL

Honorable Mike Feuer
City Attorney
City of Los Angeles
200 N. Main Street
Los Angeles, CA 90012

Re: **Proposed Establishment of Minimum Wage in the City of Los Angeles Council File No. 14-1371**

City Attorney Feuer,

This office represents a group of local restaurants regarding the proposal for establishing a local minimum wage in the City of Los Angeles ("City").[1] On April 10 and May 4, 2015 we submitted letters describing the City's authority to incorporate a "total compensation" method within local wage legislation. As described in those letters, the City may regulate wages pursuant to its police powers as long as it enacts legislation that is more stringent than the state minimum wage. Even though the inclusion of the total compensation method for certain employee sectors of the economy is within the City's recognized powers, the issue has been contested by some organizations.[2]

We submit this letter to express concerns that any local wage legislation that does not recognize the unique compensation structure of the restaurant industry will have a disproportionate impact on these local businesses. While not exhaustive of all claims and causes of action we may assert, the Fourteenth Amendment of the United States Constitution, and Article 1, Section 7 of the California Constitution, "prohibit the denial to persons of the equal protection of laws." Any wage ordinance which creates a disproportionate impact on restaurant owners will deny those owners equal protection of the law. If faced with a local wage legislation that has such a

[1] The local restaurants have formed a coalition of over 300 (to date) local businesses, known as, "Small Restaurants for Fair Wages."

[2] See, Exhibit A, April 10, 2015 Glaser Weil Letter; See Exhibit B, April 15, 2015 Coalition of Low-wage and Immigrant Worker Advocates Letter; See Exhibit C, May 4, 2015 Glaser Weil Letter

disproportionate impact, we may have no option but to judicially challenge the legislation on all available grounds.

We will not revisit the legality of the total compensation model discussion here, but will instead focus on the disproportionate impacts that will be placed on the restaurant owners operating a small business if a total compensation system is not included as part of any wage legislation enacted by the City.[3] Thus far, the public debate surrounding the discussion on tips has been focused only on how tips should be treated in any compensation package. However, this is only one component of the tip discussion. Tips also have multiple financial impacts on restaurant owners. For example, employee tips are treated as compensation for several purposes, including:

- Federal Insurance Contribution Act (FICA)—A restaurant must make its FICA payments on the tips received by his or her employee (Social Security and Medicare);

- Credit Card Service Charges—When employees receive tips from a customer's credit card, the service charge imposed by the credit card company is absorbed by the restaurant, not the employee; and

- Workers' Compensation—Employee tips are regularly included in part of the wage base on which the restaurants workers' compensation rates are calculated.

If the City enacts wage legislation that does not provide a total compensation method for the restaurant industry, this industry will be disproportionately impacted. Absent a total compensation system, restaurant owners would not only be required to pay an increased wage and associated taxes, but would also be required to incur additional expenses associated with tips being defined as compensation for tax and insurance purposes.

For these reasons, we encourage the City to exercise the fullest extent of its police powers and enact legislation that includes a minimum level of total compensation that incorporates the state minimum wage and documented gratuities. If the City adopts legislation that fails to do so, the Small Restaurants for Fair Wages will have no option but to seek a judicial remedy.

[3] For more on the total compensation system, see Exhibits A and C

Thank you for your consideration. If you have any questions, please do not hesitate to contact this office.

Sincerely,

TIMOTHY B. MCOSKER
of GLASER WEIL FINK HOWARD AVCHEN & SHAPIRO LLP

TBM:cp
Enclosures

Exhibit A

Glaser Weil

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April 10, 2015

VIA E-MAIL AND FIRST CLASS MAIL

Honorable Mike Feuer
City Attorney
City of Los Angeles
200 N. Main Street
Los Angeles, CA 90012

Re: **Proposed Establishment of Minimum Wage in the City of Los Angeles Council File No. 14-1371**

City Attorney Feuer,

This office represents a group of local restaurants with respect to the City of Los Angeles ("City") proposal for establishing a local minimum wage.[1] This letter describes the authority of the City to incorporate within the local legislation a "total compensation" method for certain employee sectors of the economy.

Last year was a very active period for the discussion of a minimum wage policy for the City. In October 2014, the City Council passed a motion requesting the City Attorney, with the assistance of the Chief Legislative Analyst ("CLA") and the Chief Administrative Officer ("CAO"), to draft an ordinance establishing a minimum wage for all private employees working in the City. The motion also directed the CLA and CAO to procure an independent study of minimum wage policies and issues to further educate and inform the Council during deliberations. On October 21, 2014, Councilmembers Mitch O'Farrell and Bob Blumenfield introduced a motion, seconded by Councilmembers Paul Kerkorian, Nury Martinez and Felipe Fuentes, which instructed the CLA and CAO to, among other things, evaluate the allowance of counting total taxable compensation towards the minimum wage. As the City continues to engage in discussions pertaining to increases in wages, the question of how to deal with the unique nature of the restaurant industry requires careful attention. Early discussions surrounding employee income have focused almost exclusively on wages, as opposed to total compensation. Unfortunately, this narrow view does not accurately capture the restaurant industry's payment structure and has not been adequately accounted for in those discussions.

[1] The local restaurateurs have formed a coalition of over 250 (to date) local businesses, known as "Small Restaurants for Fair Wages."

For example, some stakeholders may take the position that gratuities received by restaurant employees cannot be considered in the discussion of the City minimum wage because *state* law prohibits it. These stakeholders may point to California Labor Code Section 351 ("Section 351") which provides that:

> 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. An employer that permits patrons to pay gratuities by credit card shall pay the employees the full amount of the gratuity that the patron indicated on the credit card slip, without any deductions for any credit card payment processing fees or costs that may be charged to the employer by the credit card company. Payment of gratuities made by patrons using credit cards shall be made to the employees not later than the next regular payday following the date the patron authorized the credit card payment.

The California Supreme Court ruled that Section 351 barred the Industrial Wage Commission from establishing a "two tier" minimum wage that set a lower *state* minimum wage for tipped employees, than for non-tipped employees. *Henning v. Industrial Wage Com.* (1988) 46 Cal.3d 1262.

Reliance on Section 351 with respect to a local wage ordinance discussion, where the municipality desires to increase local wages over the *state* minimum, would be misplaced. There is no case law or other authority that applies Section 351 to municipal wage ordinances. This is not surprising, because all of the case law involving the application of Section 351 involves an employer's obligation to pay a *state* minimum wage. In those cases, the application of Section 351 prohibits tip credits that lessen an employer's obligation to pay the *state* minimum. As we all know, no employer may pay an employee an amount below the *state* minimum wage. In addition, no local ordinance can circumvent the *state* law to authorize a lower wage than mandated by the *state*.

However, a City ordinance establishing a higher *local* wage is not expressly restricted by either Section 351 or the applicable case law, as long as the employee is receiving at least the *state* minimum wage. Article XI, Section 7 of the California Constitution provides that a "...city may make and enforce with its limits all local police, sanitary and other ordinances not in conflict with general laws. The authority

to regulate wages falls within a municipalities police power. *RUI One Corp v. City of Berkeley*, (9th Cir. 2004) 371 F.3d 1137, 1150. In addition, California Labor Code Section 1205(b) ("Section 1205(b)") authorizes a municipality to exercise its local police powers in this arena provided it does so in a more "stringent manner" than the state. Thus, pursuant to Section 1205(b), a city has the authority to enact a *local* minimum wage ordinance as long as it is higher (more stringent) than the *state* minimum wage. This same authority supports the inclusion of a total compensation definition in the local ordinance for certain employee sectors that have a wage base at or above the *state* minimum.

Also relevant in a discussion regarding the application of Section 351 is the original intent of the law. As stated in Labor Code Section 356, the purpose of Section 351 is "to prevent fraud upon the public in connection with the practice of tipping..." which would arguably occur when an employer takes the tip without informing the patron who left the tip that the employee will not benefit from that gratuity. Equally important are the changes that have occurred since the passing of Section 351. The dynamic of the entire restaurant industry has changed dramatically since this law was last amended in the 1970s. In particular, the manner in which tips are recorded and reported has shifted from mostly cash left on the table to amounts added in a credit card payment. Further, restaurant employers are required to report and withhold tax on tip amounts in accordance with Internal Revenue Service ("IRS") regulations. The tips are included in the calculation of workers' compensation and other mandated programs. These documented and taxed tipped amounts are the only amounts that should be accounted for in a total compensation model.

As stated above, Section 351 was not adopted with municipal wage ordinances in mind, therefore there is no reason to use it to artificially set barriers that limit the police powers of the City. Rather, we can embrace this opportunity to recognize the changes in gratuities in the restaurant industry and establish a fair and reasonable program within the existing legal structure. Within the existing legal framework and pursuant to the authority of Section 1205(b), the City can lawfully establish a *local* minimum total compensation level for certain gratuity earning restaurant workers that differs from the *local* minimum wage established for other workers and industries, as long as each are at or above the *state* minimum wage. Under the total compensation method, a restaurant employee is guaranteed a minimum compensation level which takes into account documented compensation received from gratuities. For purposes of illustration, let's say that the minimum compensation level is set at "X." X would consist of the *state* minimum wage and documented gratuities recognized as compensation by the IRS. In the event the employee's total compensation does not equal X, the employer would be responsible for making up the difference so that the employee is paid a total compensation of X. Only those gratuities that are documented on the employee's pay check in accordance with the

IRS reporting standard can be counted towards the total compensation, thus ensuring the integrity of the total compensation level.

In conclusion, as demonstrated above, the City may regulate wages pursuant to its police powers. The City is authorized to exercise those powers as long as it does so in a manner that is more stringent than the *state* wage limit. The enactment of the total compensation method for certain employee sectors of the economy is within the City's recognized powers. By utilizing the total compensation method for certain restaurant employees, the City can exercise its police power to meet its goal of providing working Angeleno's a higher level of income, while at the same time recognizing the unique structure of the restaurant industry and the important role it plays in the economy of the City.

For all of these reasons, we respectfully advise that the City enact legislation which provides certain sectors of the economy with a minimal level of total compensation which incorporates the *state* minimum wage and documented gratuities as described above. We look forward to participating in continued discussions regarding this important issue.

Sincerely,

TIMOTHY B. MCOSKER
of GLASER WEIL FINK HOWARD AVCHEN & SHAPIRO LLP

TBM:cp

cc: Mayor Eric Garcetti
City Council President Herb Wesson and Honorable Members of the Los Angeles City Council

Exhibit B

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

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,

Mark Schacht
Deputy Director
California Rural Legal Assistance Foundation (CRLAF)

Carole Vigne
Staff Attorney & Director, Wage Protection Program
Legal Aid Society-Employment Law Center

Matthew Sirolly
Director
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Exhibit C

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May 4, 2015

VIA E-MAIL AND FIRST CLASS MAIL

Honorable Mike Feuer
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City of Los Angeles
200 N. Main Street
Los Angeles, CA 90012

Re: **Proposed Establishment of Minimum Wage in the City of Los Angeles Council File No. 14-1371**

City Attorney Feuer,

This office represents a group of local restaurants regarding the proposal for establishing a local minimum wage in the City of Los Angeles (City).[1] On April 10, 2015, we submitted a letter describing the City's authority to incorporate a "total compensation" method within local wage legislation. As described in that letter, the City may regulate wages pursuant to its police powers. The City is authorized to exercise these powers, as long as it enacts a local wage ordinance that is more stringent than the state minimum wage. Thus, the inclusion of a total compensation method for certain employee sectors of the economy is within the City's recognized powers.

We are aware that the Coalition of Low-Wage and Immigrant Worker Advocates (CLIWA) also submitted a letter regarding these issues. CLIWA challenges the total compensation method by relying on purported authorities which have no precedential value. For instance, CLIWA argues that Labor Code Section 351 would apply with equal force were a municipality to attempt to allow a tip credit system. To support this argument, CLIWA points to dicta from a demurrer order issued by the Alameda County Superior Court. (*Roberts v. RUI One Corp.*, Case No. 2002-049644, Alameda County Superior Court, Order re Demurrer to First Amended Complaint, pg. 6). While CLIWA argues that a snippet from this order is controlling authority, of course it is not as a demurrer is designed to test the sufficiency of a pleading—not the merits of the issues. Furthermore, a thorough reading of the order actually damages CLIWA's argument. The Court reasoned there was no basis to limit the scope of Labor Code

[1] The local restaurants have formed a coalition of over 250 (to date) local businesses, known as, "Small Restaurants for Fair Wages."

Section 351 to attempts by the employer to credit tips against the state minimum wage because the Berkeley Living Wage Ordinance (Berkeley LWO) was entirely silent on tips. In fact, the Court implied that if the Berkeley LWO included language on tips, it may have reached a different result. Further still, the order specifically recognized that the *Henning* case addressed state minimum wage laws and the ordinance at issue was enacted by a municipality. CLIWA's reliance on dicta from this order is misguided and uninformative. In addition, the order provides no guidance to the discussion on a total compensation model.

CLIWA also cites a memorandum issued by the San Diego City Attorney dated July 9, 2014 on the "Application of California Labor Code Section 351 to a Local Minimum Wage Ordinance." CLIWA uses this memorandum to support its argument that Section 351 prohibits a total compensation method. However, CLIWA fails to recognize that in the same memorandum the San Diego City Attorney states that "...beyond a direct tip credit, it is unclear the impact of Section 351 on other alternatives such as a two tiered minimum wage ordinance, total compensation model or exception for tipped employees. Adoption of any of these models could result in adjudicating new law in the State of California." (San Diego City Attorney Memorandum, pg. 2).

Finally, CLIWA predictably relies on excerpts from *Henning v. Industrial Wage Com.* (1988) 46 Cal.3d 1262. As you are well aware, the *Henning* case dealt with the establishment of a state minimum wage by the state's Industrial Wage Commission and did not involve or consider local wage ordinances which set total compensation levels higher than the state minimum wage. We do not refute that tips belong to an employee nor do we disagree that the Interstate Wage Commission was not permitted to allow an employer to obtain the benefit of such tips by paying a tipped employee a lower state minimum wage than he would be obligated to pay if the employee did not receive the tips. As we explained in our earlier letter, wages and total compensation are not the same and should not be treated as such.

Under the total compensation method, tips received by an employee unquestionably belong to the employee. Consistent with Section 351 and *Henning*, the employer is still obligated to pay the employee the state minimum wage without any offset for the tips received. The City is empowered to determine what components are included within the definition of total compensation, as long as the state minimum wage requirements are met. As such, the inclusion of documented gratuities in the definition of a total compensation method, does not violate Section 351 or the holding in *Henning*. To say otherwise would be to impose an unlawful limit on the powers of the municipal corporation.

It is apparent from CLIWA's letter, that it recognizes the City's authority to enact municipal wage ordinances. However, rather than embracing that authority to address the unique structure of certain service industries, CLIWA seeks to set an

artificial barrier to the City's authority by misconstruing the application of California Labor Code Section 351 and the applicable case law.

We encourage the City to recognize the extent of its police powers and consider legislation that includes a total compensation model for certain sectors of the economy. We look forward to participating in continued discussions regarding this important issue.

Sincerely,

TIMOTHY B. MCOSKER
of GLASER WEIL FINK HOWARD AVCHEN & SHAPIRO LLP

TBM:cp

cc: Mayor Eric Garcetti
City Council President Herb Wesson and Honorable Members of the Los Angeles City Council