Failing Twice Over: Fifth Circuit Strikes Down DOL Tip-Credit Rule as contrary to FLSA and Arbitrary and Capricious in post-Chevron decision

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On Friday, August 23, 2024, the U.S. Court of Appeals for the Fifth Circuit vacated a 2021 U.S. Department of Labor ("DOL") Final Rule on employer "tip credits" as being contrary to the text of the Fair Labor Standards Act ("FLSA") 29 U.S.C. 203 et seq., and at the same time, was also found to be an "arbitrary and capricious" exercise of federal agency action in violation of the Administrative Procedure Act ("APA"). The decision is illustrative of how federal courts countenance federal agency rulemaking without the deference formerly afforded by the *Chevron* deference doctrine, which was eliminated by the U.S. Supreme Court earlier this year in *Loper Bright Enters. v. Raimondo,* 144 S. Ct. 2244 (2024).

In *Restaurant Law Center, et al, v. United States Department of Labor (No 23-50562) (Slip Op. August 23, 2024 5th Cir.),* the Appellants challenged a Final Rule promulgated by the DOL that restricts when employers may claim a "tip credit" for "tipped employees" under the FLSA. Under the FLSA, the tip credit enables an employer to pay tipped employees as low as $2.13/hr based on the rationale that a large portion of the employees' total earnings come from tips. The employer must ensure that tips make up the difference between $2.13/hr and minimum wage.

The specific text of the statute defines a "tipped employee" as "any employee engaged in an occupation in which he customarily and regularly receives more than $30 a month in tips." 29 U.S.C. 203(t). The DOL has been interpreting the FLSA tip credit through rulemaking and sub-regulatory guidance since it was amended into law in 1966. From 1966 through approximately 2009, the DOL's interpretation and sub-regulatory guidance remained largely unchallenged. From 2009 to the promulgation of the final rule in question in 2020, the DOL's interpretation, and therefore enforcement posture, became more of a political football, being variously rescinded and reinstated, depending on the Presidential Administration at the time. In December 2021, the DOL issued a different Final Rule, and added a new definition of what it means to be "engaged in a tipped occupation" under 29 U.S.C. 203(t).

Pursuant to the Final Rule, an employer may "take a tip credit for work performed by a tipped employee that is part of the employee's tipped occupation." The Rule defines categories of work:

- "tip-producing" work by the employee (e.g. providing table service),
- directly supporting work (e.g. setting and bussing tables) and
- work not part of the tipped occupation (e.g. "preparing food").

The employer may only take the tip credit for "tip-producing work" and may not take credit for any "directly supporting work" if it exceeds 20% of the employee's workweek. The new Final Rule added a new "temporal" element in that the "directly supporting" work could not be performed for more than 30 minutes at any given time.

Legal Challenge involves *Two* important legal doctrines of Administrative Law

The legal issue on appeal to the Fifth Circuit involved two important legal doctrines. First, whether the Final Rule was a permissible exercise of administrative agency authority pursuant to the APA, or was it "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5. U.S.C. 706(2)(A). The second legal issue was how a regulation, promulgated pursuant to *Chevron,* -- and therefore legitimately entitled to agency deference at the time -- should be examined by a court under the APA following the demise of *Chevron* deference.

***Chevron* deference.**

Under *Chevron*, a court had to defer to "permissible" agency interpretations if Congress had not previously addressed the issue. The reasoning in general was that legislators could not possibly anticipate every potential outcome of the statute in application, and therefore the agencies vested with the authority to carry out the law were in the best position to interpret the law.

The Court in this case noted its task, without *Chevron,* was to "parse the text of the FLSA using the traditional tools of statutory interpretation."Applying the "ordinary meaning" of the terms "engaged in" and "occupation", the Fifth Circuit concluded that the DOL had, in promulgating a rule that divided up component tasks of a tipped employee into "tip-producing" and "non-tip producing" tasks was "so granular", it created confusion not contemplated by Congress when including the tip-credit in 1966.

The Court stated: "The FLSA does not ask whether duties composing that given occupation are themselves each individually tip producing" but rather, plainly asks whether the employee, applying ordinary common understanding of terms is "engaged in a given occupation that customarily and regularly receives more than $30/month in tips." The Court thus found that the DOL Final Rule applied the statutory tip credit in a manner inconsistent with the text of the FLSA. Accordingly, because there is no longer any judicial deference afforded to the DOL in its rulemaking, the Court concluded that the Final Rule ran afoul of the APA as "not in accordance with law."

***Arbitrary and Capricious Standard* remains applicable but diminished.**

An agency rule is arbitrary and capricious if: "[T]he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."

The Fifth Circuit panel acknowledged its duty to assess the rule through a post-*Chevron* lens, and opined "we cannot think of any occupation for which every duty is directly tip-producing, as the Final Rule demands The Final Rule ties the tip credit not to the *character* of these various duties as integral to their respective occupations, but to the amount of *time* that these duties take." Because the Final Rule impermissibly replaced the Congressionally chosen standard of "occupation" with a DOL invented standard, the timesheet, the Final Rule also failed the arbitrary and capricious standard as contrary to the FLSA.

The Employer Takeaway

The Fifth Circuit's decision, although limited to a specific occupation (tipped employees) is instructive. First, courts (and not necessarily agencies) will continue to be called on to interpret statutes more often, or at least until Congress passes legislation curing any ambiguities in laws like the FLSA. Second, employers, therefore, may now have a good faith reason to question and/or respectfully challenge enforcement action by the DOL based on its own rulemaking. Third, until Congress takes further action on this topic, or the White House changes parties, this will continue to be an unsettled area of the law.

Employers with any questions about this topic or any FLSA matters are encouraged to contact partner Kevin A. Moore or any member of the Barley Snyder Employment Practice Group.

WRITTEN BY:

Kevin A. Moore

Partner

Tel: (610) 370-8110

Email: kmoore@barley.com