Blogs
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Fifth Circuit Hits 0% on the Department of Labor's Tip Credit Rule

The U.S. Court of Appeals for the Fifth Circuit recently determined that the Department of Labor (DOL) violated the Administrative Procedures Act (APA) in issuing its "Tip Credit" final regulations and vacated the final rule.

The Fifth Circuit's decision continues the immediate effects from the 2024 reversal of the *Chevron* principle by the Supreme Court of the United States in a case called *Loper Bright Enterprises, et.al. v. Raimondo, et.al.* *Chevron* deference previously provided that courts defer to an agency's interpretation of an ambiguous statutory provision if that interpretation was a "reasonable" interpretation of the statute. In *Loper Bright*, the Supreme Court determined that agency interpretations may be considered along with other factors but the deference to an agency's reasonable interpretation is no longer required. A summary of the *Loper* Bright decision is found here. Post *Loper Bright*, courts have analyzed agency decisions differently to interpret the statute at issue. One example is the Federal Trade Commission's (FTC) noncompete rule, which the Fifth Circuit held exceeded the FTC's authority. A summary of that decision is found here.

This tip credit ruling arose out of Section 203 of the Fair Labor Standards Act (FLSA), which allows employers to claim a credit for tipped employees that, in turn, allows employers to pay less than the minimum wage. Claiming the tip credit, employers may make up the difference between the tipped employee's wage floor ($2.13) and the standard federal minimum wage ($7.25). Section 203 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."

Soon after the passage of the FLSA, a concern developed as to how to address the scenario where an employee worked in two different roles where one was not associated with tips. In DOL's eyes, this presented an employer with the opportunity to claim an excessive credit. Beginning in 1967, DOL issued rules and guidance accounting for distinctions in jobs and how to account for the credit. In general, those rules provided that an employee working in two positions, such as waiter and maintenance person, qualified as a tipped employee with respect to

the waiter tipped work and did not qualify as a tipped employee for the maintenance work. Various formulations of the rule developed into an “80/20” test which created a 20 percent cap on nontipped work related to the tipped occupation for the employer to claim the full tip credit. In 2021, the DOL finalized a rule that, among other requirements, essentially codified the 80/20 test and included a provision that expanded the 20 percent portion to include the tipped occupational work but also “directly supporting work.”

Two restaurant associations sued alleging that the regulations violated the APA and the Constitution. Among other claims, the complaint alleged that the DOL improperly took an overbroad interpretation of “engaged in an occupation” by including supporting or related work into the definition of a tipped occupation. The U.S. District Court for the Western District of Texas determined that the DOL’s actions were lawful, but the Fifth Circuit overturned the district court’s determination and vacated the rule. The panel’s opinion began with an observation that the DOL’s actions were no longer entitled to deference based on the Supreme Court’s decision in *Loper Bright*. From there, the panel embarked on its own interpretation of the tip credit provisions of the FLSA and focused on the term “engaged in an occupation,” determining that the statutory provision was intended to focus on a field of work and on the job as a whole and that the DOL’s interpretation impermissibly included tasks or duties beyond those encompassed in the “occupation” itself. While the DOL argued that the term “engaged in” indicated that Congress meant a broader interpretation, the Fifth Circuit rejected this argument, finding that it did not accord with the text of the statute. The DOL also attempted to rely on the Ninth Circuit’s *en banc* decision in *Marsh v. J. Alexander’s LLC*, 905 F.3d 610 (9th Cir.2018) (*en banc*), which held that an earlier DOL dual-jobs rulemaking did not violate the APA and was permissible under a lower level of deference. The Fifth Circuit declined to rely on the Ninth Circuit’s determination because that case predated *Loper Bright*.

In addition to interpreting the statute narrowly, the Fifth Circuit also determined that the DOL’s rulemaking was arbitrary and capricious in violation of Section 706(2) of the APA. Among other bases, the panel determined that the agency did not consider and take advantage of what the judges believed to be more appropriate alternatives available to DOL, such as a more direct focus on specific occupations rather than broad tasks.

Finding that the rule was invalid and unlawful, the Fifth Circuit determined that vacatur of the rule was the correct remedy. The vacatur order, however, did not specifically address whether the vacatur order has nationwide effect. Nonetheless, such an order is generally considered to have nationwide effect. Companies with questions on how this decision may impact pay practices, including tipping under the FLSA, should contact experienced counsel.

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