December 9, 2019

Department of Labor

Attn: Amy DeBisschop, Acting Director of the Division of Regulations, Legislation, & Interpretation, Wage & Hour Division, U.S. Department of Labor

Re: Tip Regulations Under the Fair Labor Standards Act, 84 Fed. Reg. 53,956 (proposed October 8, 2019)

Docket ID: WHD-2019-0004

The Institute for Policy Integrity ("Policy Integrity") at New York University School of Law[1] respectfully submits the following comments to the Wage and Hour Division within the Department of Labor ("DOL" or the "Department") regarding its proposal to implement new tip regulations under the Fair Labor Standards Act ("Proposed Rule").[2] Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

Our comments focus on DOL's legal and economic justifications for the Proposed Rule and recommend as follows:

- DOL should better explain why the Proposed Rule is consistent with § 203(m)(2)(B) of the Fair Labor Standards Act ("FLSA"), which provides that an employer may not "keep tips received by its employees for any purposes."
- DOL should explain why its proposed "reasonable time" standard for the performance of non-tipped duties by workers receiving the tipped minimum wage will be more administrable than the prior "80/20" standard.
- DOL should reconsider the assumptions it relies upon when calculating potential inter-employee transfers that will result from the Proposed Rule.
- DOL should quantify potential transfers from employees to employers that will result from the Proposed Rule.
- DOL should take into account social costs that will accompany any transfer from employees to employers.
- DOL should provide a more substantial explanation of the Proposed Rule's alleged benefits.
- DOL should better explain the conditions under which it believes the Proposed Rule will decrease deadweight loss in the labor market.

[1] This document does not purport to present New York University School of Law's views, if any.

[2] *See* Department of Labor, Tip Regulations Under the Fair Labor Standards Act, 84 Fed. Reg. 53,956 (proposed Oct. 8, 2019) (to be codified at 29 C.F.R. pts. 10, 516, 531, 578, 579 & 580) [hereinafter 2019 Proposed Rule].

Background

In 2011, DOL issued a rule that, among other things, prohibited employers from requiring their employees to participate in "nontraditional" tip pools—i.e., those in which tips were shared with employees who did not customarily receive tips ("2011 Rule").[3] Commentators characterized the 2011 Rule as an effort "to close a 'loophole' in section 203(m) whereby employers could use tip pooling to subsidize the wages of untipped employees."[4] In 2017, however, DOL proposed to rescind the portions of the 2011 Rule "that impose[d] 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" ("2017 Proposal").[5] The 2017 Proposal would have allowed employers who pay their tipped employees the minimum wage or above (i.e., employers who do not take a "tip credit" against the minimum wage for their tipped employees) to establish tip pools that include "back-of-the-house" employees who do not customarily receive tips.[6]

But in response to concerns that DOL's new approach would permit employers themselves to pocket a share of the tip pool, Congress blocked the agency from finalizing the 2017 Proposal. Specifically, Congress included in the 2018 Congressional Appropriations Act an amendment to the FLSA, adding section 203(m)(2)(B), which states that "[a]n employer may not keep tips received by its employees for any purposes."[7]

In October 2019, DOL published a new notice of proposed rulemaking, seeking to implement a modified regulation.[8] These comments respond to that proposal.

I. DOL should ensure that any new regulation adheres to both congressional intent and the plain meaning of the word "keep" as used in FLSA § 203(m)(2)(B)

DOL asserts that the Proposed Rule, which seeks to implement a modified tip pooling regime, adheres to the 2018 FLSA amendments.[9] But DOL also acknowledges that the Proposed Rule will allow employers to "capture" some of the tips that are nominally transferred from tipped to non-tipped employees.[10] Accordingly, DOL should explain why it believes a rule that allows for

[3] *See* Department of Labor, Updating Regulations Issued Under the Fair Labor Standards Act, 76 Fed. Reg. 18,832, 18,841-42 (Apr. 5, 2011).
[4] Evan Mix, *Ninth Circuit Limits Tip Pooling to Customarily Tipped Employees*, SHEPPARD MULLIN (Feb. 29, 2016), https://www.laboremploymentlawblog.com/2016/02/articles/wage-and-hour/ninth-circuit-limits-tip-pooling-to-customarily-tipped-employees.
[5] Department of Labor, Tip Regulations Under the Fair Labor Standards Act, 82 Fed. Reg. 57,395, 57,395 (proposed Dec. 5, 2017) (to be codified at 29 C.F.R. pt. 531) [hereinafter 2017 Proposal].
[6] *See id.* at 57,396.
[7] Consolidated Appropriation Act, 2018, 2018 Pub. L. No. 115-141, 132 Stat. 348 (codified as amended at 29 U.S.C. § 203(m)(2)(B) (2018)).
[8] *See* 2019 Proposed Rule, 84 Fed. Reg. 53,956,
[9] *See id*. at 53,957 (describing the expansion of nontraditional tip pooling as "consistent with Congressional action"); *id.* at 53,961 (describing the expansion of nontraditional tip pooling as "[c]onsistent with the statutory language").
[10] 2019 Proposed Rule, 84 Fed. Reg. at 53,968.

such capture is consistent with Congress's instruction that employers may not "keep" their employees' tips for "any purposes."

When DOL released the 2017 Proposal, critics warned that it would incentivize employers to forgo taking a tip credit not only so that tips received by employees could be shared with non-tipped staff but also so that the tips could legally be retained in part—or even in full—by employers themselves.[11] Indeed, the 2017 Proposal Rule acknowledged this possible result,[12] causing substantial public outcry from workers' rights activists,[13] state Attorneys General,[14] and regulatory policy organizations.[15]

Congress responded to the public backlash by amending the FLSA as part of the 2018 Congressional Appropriations Act. The Act added a new clause, § 203(m)(2)(B), which explicitly prohibits an employer from "keep[ing] tips received by its employees *for any*

---

[11] *See, e.g.*, Andrea Strong, *Trump Is About to Make Tip-Pooling Legal Again. Here's What That Means for Restaurant Workers*, EATER (Dec. 5, 2017, 3:29 pm), https://www.eater.com/2017/12/5/16708374/tipping-laws-trump-department-of-labor-changes.

[12] *See* 2017 Proposal, 82 Fed. Reg. at 57,405 ("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) . . . ."); *id.* (noting that the 2017 Proposal would enable employers to utilize tips received by employees "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"); *id.* at 57,409 ("[C]hanges 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*.") (emphasis added).

[13] *See, e.g.*, Irene Tung & Teófilo Reyes, *Wait Staff and Bartenders Depend on Tips for More Than Half of Their Earnings*, NATIONAL EMPLOYMENT LAW PROJECT (Jan. 2018), https://s27147.pcdn.co/wp-content/uploads/NELP-ROC-Data-Brief-Tip-Rule.pdf (noting that "[r]estaurant servers and bartenders could lose control of a large portion of their earnings, if a proposed rule change by the Trump Labor Department goes into effect"); American Federation of Labor and Congress of Industrial Organizations, Comment Letter on Tip Regulations Under the Fair Labor Standards Act (Feb. 5, 2018), *available at* https://aflcio.org/statements/letter-department-labor-urging-them-not-weaken-wage-protections-tipped-workers (stating that "[a]llowing employers to require redistribution of tips to back of house workers merely provides an incentive for employers to keep base wages low for cooks, dishwashers, and others, subsidized by the earnings from bartenders and wait staff," and raising concerns that DOL's "adoption of the changes proposed in this NPRM will likely result in lower earnings for the already vulnerable tipped workforce, an increased number of women living in poverty, and reduced incentives for employers to raise base wages across the board now or in the future").

[14] *See* Department of Justice, State of California, Comment Letter on Tip Regulations Under the Fair Labor Standards Act (Feb. 5, 2018), *available at* https://oag.ca.gov/system/files/attachments/press_releases/Comment%20of%20State%20Attorneys%20General%20re%20Proposed%20Rescission%20of%20Tip%20Regulations%20%28003%29.pdf (comment letter signed by the Attorneys General of California, Illinois, Pennsylvania, Connecticut, Delaware, District of Columbia, Iowa, Maine, Maryland, Massachusetts, New York, North Carolina, Oregon, Rhode Island, Vermont, Virginia, and Washington expressing opposition to DOL's 2017 Proposal).

[15] *See, e.g.*, Institute for Policy Integrity, Comment Letter on Tip Regulations Under the Fair Labor Standards Act (Jan. 4, 2018), *available at* https://policyintegrity.org/documents/tip_rule_rescission_comments_v2.pdf; Heidi Shierholz et al., *Employers Would Pocket $5.8 Billion of Workers' Tips Under Trump Administration's Proposed 'Tip Stealing' Rule*, ECONOMIC POLICY INSTITUTE (Dec. 12, 2017), https://www.epi.org/files/pdf/139138.pdf (noting that, "even now, when employers are prohibited from pocketing tips, many still do," and positing that, "[w]ith that much *illegal* tip theft currently taking place, it's clear that when employers can legally pocket the tips earned by their employees, many will").

purposes, including allowing managers or supervisors to keep any portion of employees' tips, regardless of whether or not the employer takes a tip credit."[16]

The Proposed Rule, however, does not prevent employers from capturing a portion of their employees' tips through the use of nontraditional tip pooling. As DOL acknowledges, "because back-of-the-house workers could now be receiving tips, employers may offset this increase in total compensation by reducing the direct wage that they pay back-of-the-house workers (as long as they do not reduce these employees' wages below the applicable minimum wage)."[17] In other words, under the Proposed Rule, employers will be able to replace money that they are currently paying back-of-the-house workers out of their own pocket with money taken from front-of-the-house workers' tips.

Thus, while the Proposed Rule does not allow employers to *directly* seize tips by participating in the tip pool, as was permitted under the 2017 Proposal, the Proposed Rule does permit *indirect* capture of those tips. Because the Proposed Rule's functional consequences may be no different than those of the 2017 Proposal, DOE cannot reasonably proceed to finalization without better explaining why the Department believes such a result is in keeping with Congress's 2018 amendments to the FLSA. Specifically, DOL should explain why the situation permitted by the Proposed Rule—in which an employer indirectly captures some portion of an employee's tips—is not a violation of Congress's instruction that employers may not "keep" tips received by employees. If DOL cannot provide such an explanation, it should not finalize the Proposed Rule.

There are two potential interpretations of the phrase "keep tips received by its employees." Under a *formalist* reading, the phrase could be interpreted to mean only that an employer may not require employees to surrender their tips directly to the employer. For example, if a waiter received a five-dollar bill as a tip, the employer could not keep that physical bill. But, under this reading, the employer *could* require the employee to transfer the five dollars to back-of-the-house staff by means of a tip pool and then could reduce the wage for those back-of-the-house staff by five dollars—thus ensuring that the employer retains the value of the tip. Alternatively, under a *functionalist* reading, the phrase could be interpreted to mean that employers cannot re-allocate the value of tips received by employees to themselves, whether by directly seizing those tips or by requiring the employee to transfer the tip to a non-tipped employee and then reducing the non-tipped employee's direct cash wage by a commensurate amount.

Admittedly, if nontraditional tip pooling is permitted at all, it could be difficult to design a rule that would prevent employers from *ever* using employees' tips for the employers' own financial benefit. For example, even if a rule barred employers from lowering back-of-the-house employees' direct cash wages immediately following implementation of a nontraditional tip pool, the employers would still retain discretion to capture some value from the tip by, for instance, forgoing future pay increases for back-of-the-house staff that would have been offered in the absence of the tip pool or offering future back-of-the-house hires lower wages than would

---

[16] Consolidated Appropriation Act, 2018, 2018 Pub. L. No. 115-141, 132 Stat. 348 (codified as amended at 29 U.S.C. § 203(m)(2)(B) (2018)) (emphasis added).

[17] 2019 Proposed Rule, 84 Fed. Reg. at 53,968. DOL further explains that "across a longer time horizon, market adjustments increasingly allow employers to capture the transfer [from employees]." *Id.* For example, over time, employers could offer newly hired employees lower wages, reduce wages for current employees, or forgo offering raises to employees in circumstances where they otherwise would have.

have been offered in the absence of the tip pool. In light of these potential obstacles, DOL should more fully explore alternatives that might allow for nontraditional tip pooling under even a functionalist reading of § 203(m)(2)(B).

Regardless of which interpretation of “keep” DOL adopts, the Department should explicitly state how DOL interprets the provision’s meaning, and explain why DOL believes that its selected interpretation is consistent with the amended FLSA and congressional intent. In particular, if the Department adopts the formalistic interpretation, DOL should explain why indirect transfers from tipped employees to employers are consistent with Congress’s intent in blocking implementation of the 2017 Proposal.

II. DOL should explain why its proposed “reasonable time” standard for the performance of non-tip-generating work by tipped employees is more administrable than the “80/20” standard

DOL seeks to amend the Department’s regulations “to reflect recent guidance explaining that an employer may take a tip credit for any amount of time that an employee in a tipped occupation performs related, non-tipped duties contemporaneously with his or her tipped duties, or for a *reasonable time* immediately before or after performing the tipped duties.”[18] DOL claims that this “reasonable time” standard will provide employers with a less cumbersome and more easily administrable rule than did the Department’s prior “80/20” standard for the performance of non-tip-generating work by tipped employees receiving less than the full minimum wage. But DOL does not provide any analysis to support this claim regarding the new standard’s superior administrability.

Under the 80/20 standard that DOL applied for decades prior to 2018, an employer could not “take a tip credit for the time an employee spent performing related duties that do not produce tips if that time exceeded 20 percent of the employee’s workweek.”[19] Under the Proposed Rule, by contrast, there is no numerical limit on the proportion of a tipped employee’s working hours that can be devoted to non-tip-generating work before the employer loses eligibility for a tip credit. Instead, an employer may take a tip credit for time that tipped employees spend “perform[ing] related, non-tipped duties—as long as those duties are performed contemporaneously with, or for a *reasonable time* immediately before or after, tipped duties.”[20]

DOL argues that the 80/20 standard “was difficult for employers to administer and led to confusion, in part because employers lacked guidance to determine whether a particular non-tipped duty is ‘related’ to the tip-producing occupation.”[21] But DOL’s new “reasonable time” standard seems even more ambiguous and thus less administrable. Under both standards, the employer must keep track of how much time each employee spends on tipped and non-tipped duties. But under the Proposed Rule, the employer will also need to make a “reasonableness” determination, which is more cumbersome than applying the straightforward 80/20 standard. Specifically, although the new standard requires any non-tipped duties to be performed “immediately before or after . . . tipped duties,” it does not provide a clear indication of the

[18] 2019 Proposed Rule, 84 Fed. Reg. at 53,957 (emphasis added).
[19] *Id.* at 53,963.
[20] *Id.* (emphasis added).
[21] *Id*.

amount of time that a worker could "reasonab[ly]" spend on the non-tipped duties relative to the tipped duties. As a result, workers' rights advocates have raised concerns that this proposed change could result in "employers assigning excessive non-tip generating work and potentially reducing overall wages as a result."[22] For example, an employer could require a traditionally tipped employee to perform hours of prep work upon arrival for their shift, only to dismiss them after they have completed a minimal amount of tipped duties. Given the lack of guidance and specificity offered in the Proposed Rule, it is unclear whether such a scenario would be permitted within DOL's "reasonable" time frame standard.

Accordingly, DOL should both provide more guidance as to the parameters of the "reasonable time" standard and better explain why it expects this to be more administrable than the 80/20 standard. In the absence of such analysis, DOL will not have provided a "reasoned explanation" for its change of policy.[23]

III. DOL should improve its cost-benefit analysis

Executive Order 12,866 requires agencies to assess the costs and benefits of any economically significant regulatory action, including, but not limited to, the action's expected effects on "the efficient functioning of the economy and private markets," "health," and "safety."[24] The agency should "propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs," and after considering "all costs and benefits of available regulatory alternatives, including the alternative of not regulating."[25] This cost-benefit assessment must be based "on the best reasonably obtainable scientific, technical, economic, and other information," and effects should be quantified "to the extent feasible."[26] Longstanding guidance on regulatory analysis from the Office of Management and Budget similarly advises that "[s]ound quantitative estimates of benefits and costs, where feasible, are preferable to qualitative descriptions."[27] Because some effects are "too difficult to quantify or monetize given current data and methods," however, agencies must also "carry out a careful evaluation of non-quantified benefits and costs."[28]

Separate from the requirements of Executive Order 12,866, courts have held that "when an agency decides to rely on a cost-benefit analysis as part of its rulemaking, a serious flaw undermining that analysis can render the rule unreasonable."[29] Here, DOL's cost-benefit analysis

---

[22] Isabel Soto, *Changes to Tip Regulations*, AMERICAN ACTION FORUM (Oct. 17, 2019), https://www.americanactionforum.org/insight/changes-to-tip-regulations.
[23] FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515–16 (2009) ("[A] reasoned explanation is needed for disregarding facts and circumstances that underlay or were engendered by the prior policy.").
[24] Exec. Order No. 12,866 § 6(a)(3)(C), 58 Fed. Reg. 51,735 (Oct. 4, 1993). The Department has concluded that the Proposed Rule is an economically significant regulatory action for the purposes of Executive Order 12,866. *See* 2019 Proposed Rule, 84 Fed. Reg. at 53,967.
[25] Exec. Order No. 12,866 § 1(a), (b)(6).
[26] § 1(b)(7), 6(a)(3)(C).
[27] OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR A-4, REGULATORY ANALYSIS at 26 (2003) [hereinafter CIRCULAR A-4].
[28] *Id.* at 26–27.
[29] Nat'l Ass'n of Home Builders v. EPA, 682 F.3d 1032, 1040 (D.C. Cir. 2012); *see also* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (stating Administrative Procedure Act requires agency to "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made" (internal quotation marks omitted)).

is flawed in several respects. Before the Department can reasonably finalize this proposal, it should (1) reassess the assumptions underlying its calculation of potential transfers from front-of-the-house employees to back-of-the-house employees, taking into account search and travel costs and the lack of perfect competition in the restaurant industry; (2) calculate potential transfers from employees to employers that will result from the Proposed Rule; (3) address the possibility of social costs resulting from those transfers; (4) better explain what it sees as the Proposed Rule's benefits; and (5) provide analysis to support its claim that the Proposed Rule will decrease deadweight loss in the labor market.

A. DOL should reconsider the assumptions underlying its inter-employee transfer payment calculation

In calculating the potential transfer payments away from front-of-the-house employees, DOL relies on flawed assumptions that undermine the validity of its model. Generally, DOL predicts that some employers will choose to institute a nontraditional tip pool as a result of the new regulation and that this will result in a transfer from front-of-the-house employees to back-of-the-house employees somewhere in the range of zero to $213.4 million.[30] DOL's model for calculating these transfers excludes front-of-the-house workers that DOL believes are earning a market-clearing wage. For the remaining workers, the model estimates the size of the potential transfer by reference to an "outside-option wage" for the affected workers.[31] The outside-option wage represents the compensation that a front-of-the-house worker would be able to secure in a comparable non-tipped position. DOL assumes that employers will transfer tips from front-of-the-house workers only up to the point where the workers' total compensation is equal to their outside-option wage.

The assumptions underlying DOL's model are flawed in two main respects. First, in calculating workers' outside-option wage, DOL does not account for search and travel costs associated with a job change. Workers would reasonably take such costs into account when deciding whether to leave their current job in response to the creation of a nontraditional tip pool, meaning that the outside-wage option is functionally lower than what the Department calculates. Thus, to the extent that DOL does not consider these potential costs, it underestimates the size of the potential transfer produced by the Proposed Rule, at least in the short term.

Second, DOL's model for calculating transfer payments assumes that the restaurant industry is perfectly competitive. Under this assumption, DOL excludes from its model any front-of-the-house workers earning more than the federal minimum wage in direct cash wages, because the Department considers such a wage to be market-clearing.[32] It is generally recognized among economists, however, that the restaurant industry is *not* perfectly competitive, because market competitors are highly differentiated and enjoy unique advantages such as location-specific effects.[33] Additionally, some economists posit that employers in the restaurant industry have

[30] *See* 2019 Proposed Rule, 84 Fed. Reg. at 53,970.
[31] *See id.*
[32] *See id.*
[33] *See, e.g.*, Jacob Cosman & Nathan Schiff, *Delivery in the City: Evidence on Monopolistic Competition from New York Restaurants* 1-3 (Univ. Library of Munich, Ger., MPRA Paper 96617, 2019), https://www.nathanschiff.com/Cosman_Schiff_WP_2019.pdf.

market power to set wages.[34] As a result, more workers may be vulnerable to wage transfers than DOL's model suggests, and the Department is likely underestimating the total volume of potential transfers.

For an illustrative example, suppose that a restaurant in a particularly desirable location is able to charge higher food prices than its competitors. Wait staff at this restaurant may be able to bargain for a higher direct cash wage and also enjoy tip amounts reflective of the higher food prices. However, because the restaurant's higher earnings are due to its unique location, an equivalent outside-wage option for these workers may not in fact exist. In other words, their compensation may not reflect a market-clearing wage. Thus, in response to the Proposed Rule, it is possible that the employer could choose to institute a nontraditional tip pool and transfer some of the front-of-the-house workers' tips to back-of-the-house workers, without fearing that the front-of-the-house workers will depart for another job. As a result, the Proposed Rule may affect more workers—and result in a higher total volume of inter-employee transfers—than DOL's model suggests.

B. DOL should quantify transfers to employers that will result from the Proposed Rule

For employers that currently claim a tip credit and pay back-of-the-house workers more than the minimum wage, the Proposed Rule will likely result in a transfer from employees to employers (see Figure 1, *infra*). Under the Proposed Rule, an employer can reduce back-of-the-house workers' cash wages to the applicable minimum wage and compensate them for this reduction with money placed into a nontraditional tip pool by front-of-the-house workers—thus allowing the employer to capture at least some of the value of tips placed into the tip pool. DOL explicitly recognizes this possibility, stating that "across a longer time horizon, market adjustments increasingly allow employers to capture the transfer [of tips from front-of-the-house workers]."[35] The Department unreasonably fails, however, to quantify this transfer.

Executive Order 12,866 directs that, in designing regulations, "each agency shall consider . . . distributive impacts, and equity."[36] An estimate of employee-to-employer transfers is crucial to assessing the distributional effects of the rule as required by Executive Order 12,866 and *Circular A-4*.[37] Important distributional effects "should be described quantitatively to the extent possible, including the magnitude, likelihood, and severity of impacts on particular groups."[38] Quantification of the employee-to-employer transfer may also be necessary to evaluate whether the Proposed Rule complies with the statutory prohibition on allowing employers to "keep" tips.[39]

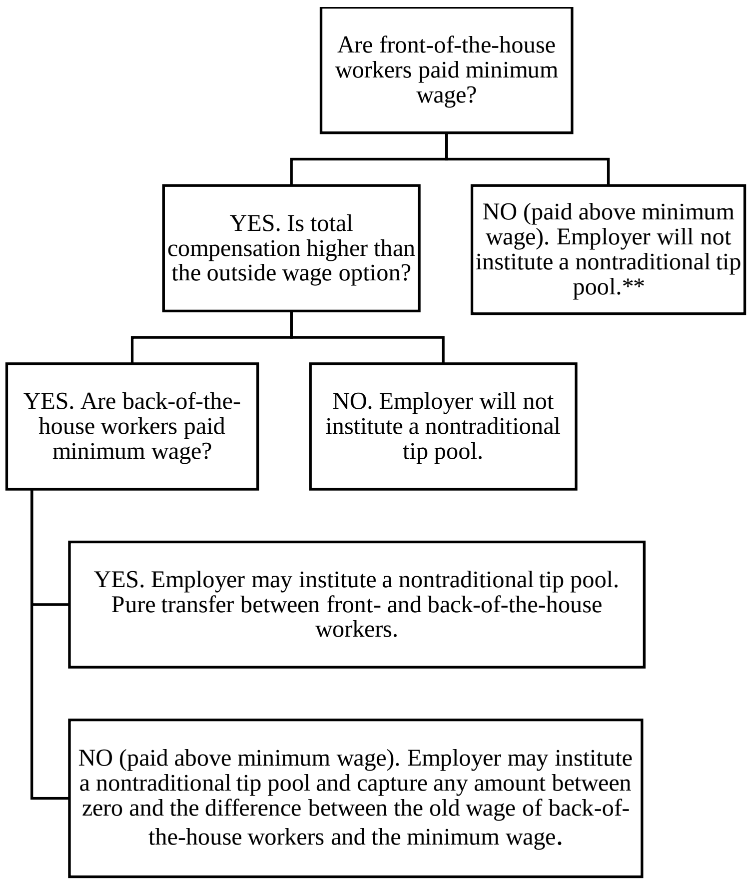
Notwithstanding these requirements, DOL makes no effort to quantify the proportion of the inter-employee transfer that employers will be able to capture over time, even though such a calculation is eminently feasible. As shown in Figure 1, *infra*, DOL could, using its already

---

[34] *See* discussion *infra* Section III(E).
[35] 2019 Proposed Rule, 84 Fed. Reg. at 53,968.
[36] Exec. Order No. 12,866 § 1(b)(5), 58 Fed. Reg. 51,735 (Oct. 4, 1993).
[37] *See id.*; CIRCULAR A-4 at 14.
[38] CIRCULAR A-4 at 14.
[39] Fair Labor Standards Act, 29 U.S.C. § 203(m)(2)(B) (stating "[a]n employer may not keep tips received by its employees for any purposes"). Section I, *supra*, discusses this statutory requirement further.

stated assumptions, isolate the subset of employers that would be able to capture the transfer. The Department could then construct a range of values for that subset using the same data sources and methods used to construct the overall transfer estimate. In the absence of such an analysis, the Department's analysis is fatally incomplete.

Figure 1. Decision Tree to Calculate Employee-to-Employer Transfers for Employers Claiming a Tip Credit*



* The chart adopts the parameters of the Proposed Rule's transfer analysis[40] and analyzes potential employee-to-employer transfers only in businesses where the employer does not claim a tip credit.

** This outcome requires that DOL maintain the assumption that employees who earn more than the minimum wage in their direct cash wage would quit if their compensation is reduced as a result of a nontraditional tip pool.[41] Section III(A), *supra*, challenges this assumption.

[40] *See* 2019 Proposed Rule, 84 Fed. Reg. at 53,968 (explaining that transfers in businesses where the employer must forgo a tip credit in order to institute a nontraditional tip pool are "not quantified due to uncertainty regarding how many employers would choose to no longer use the tip credit")

[41] *See id.* at 53,970.

C. DOL should consider potential social costs resulting from transfers to employers

A transfer of earnings from employees to employers, as described in the prior section, may result in social costs.[42] Approximately 46% of tipped workers and their families rely on public benefits to supplement their income.[43] A reduction in overall compensation may force these individuals to forgo necessary consumption of nutritious food, adequate housing, or healthcare, which may lead to adverse health consequences and other harms to the employees and their dependent family members. DOL should acknowledge the potential for such costs and explain whether and why it believes that the Proposed Rule is nevertheless cost-benefit justified. In particular, because the size of potential social costs will depend on the magnitude of the transfer from employees to employers, DOL should explain whether such costs are justified across the full range of possible transfers calculated in its cost-benefit analysis. If DOL does not believe these costs are likely to be justified by the rule's benefits, it should not move forward with the rule.

D. DOL should better support its assertions regarding the Proposed Rule's benefits

As a benefit of the Proposed Rule, DOL cites "greater flexibility [for employers] in determining their pay policies for tipped and non-tipped workers."[44] But flexibility in and of itself is not a regulatory benefit. Nor is increased flexibility for employers certain to *result* in regulatory benefits. For example, if giving employers flexibility to mandate a nontraditional tip pool could be expected to yield an overall increase in worker productivity, then that increase in productivity would be a benefit of the Proposed Rule. But, as discussed below, DOL has not provided adequate evidence or analysis to support such a finding. Conversely, if flexibility to mandate a nontraditional tip pool is valuable to an employer only to the extent that it allows the employers to indirectly capture the value of some of its employees' earnings, then the flexibility is not socially beneficial. On the contrary, allowing such transfers may yield social costs, as described in Section III(C), *supra*.

As another benefit, DOL claims that the Proposed Rule may, by facilitating tip pooling with back-of-the-house workers, provide those workers with a stronger incentive to work, thereby "improv[ing] the customer's experience."[45] But such an effect would materialize only if (1) there is, in fact, a direct relationship between wage and productivity for the affected individuals; (2) the transfer away from front-of-the-house staff results in a decrease in productivity from this staff that is smaller than the increase in productivity for back-of-the-house staff; and, most crucially, (3) the transfer is not completely captured by the employer. DOL should clearly state

---

[42] "Transfer payments are monetary payments from one group to another that do not affect total resources available to society." OFFICE OF INFO. & REGULATORY AFFAIRS, OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, REGULATORY IMPACT ANALYSIS: A PRIMER 8 (2011), *available at* https://www.reginfo.gov/public/jsp/Utilities/circular-a-4_regulatory-impact-analysis-a-primer.pdf. Social costs, on the other hand, decrease societal welfare.

[43] *See* Sylvia Allegretto & David Cooper, *Twenty-Three Years and Still Waiting for Change: Why It's Time to Give Tipped Workers the Regular Minimum Wage*, ECONOMIC POLICY INSTITUTE (July 10, 2014), https://www.epi.org/publication/waiting-for-change-tipped-minimum-wage.

[44] Proposed Rule, 84 Fed. Reg. at 53,972.

[45] *Id.*

these assumptions and explain why it believes they are valid, especially given that it explicitly recognizes that the Proposed Rule may result in a transfer from employees to employers.[46]

Furthermore, even if a transfer of earnings from front-of-the-house workers to back-of-the-house workers would increase productivity on a dollar-for-dollar basis, an employer's implementation of a nontraditional tip pool might not yield an *aggregate* increase in productivity if it prompts consumers to leave smaller tips. DOL's analysis implicitly assumes that employers can transfer some of their front-of-the-house workers' tips to back-of-the-house workers without reducing the overall size of the tip pool. But the 2017 Proposal acknowledged that "[r]eallocation of tips may have . . . some impact on the tipping behavior of customers."[47] Although DOL claimed it could not quantify those impacts "[d]ue to data limitations,"[48] an unquantifiable impact is not the same as an absence of impact. Because DOL has already acknowledged that changing the rules can affect tipping, it is unreasonable for the Department to implicitly assign the effect zero weight in its analysis.[49]

DOL can draw on academic literature to evaluate the impact of the Proposed Rule on tipping behavior. Some empirical evidence suggests that tipping is a social norm that does not respond to service quality.[50] Therefore, it is possible that customers would not respond to something as opaque as whether a restaurant operates a nontraditional tip pool, in which case DOL's assumption of an unaltered tip rate would be valid. However, another theory suggests that social norms emerge as a way for society to correct perceived market failures and that tipping is one such norm.[51] By that logic, tipping rates could be affected in the long run if customers become aware of the effects of nontraditional tip pools, including the potential transfer to employers, and no longer view tipping as an appropriate way to correct a perceived market failure of inadequate pay for tipped staff.[52] Ultimately, DOL should better explain whether and why it believes that tipping rates will be unaffected by the Proposed Rule.

E. DOL should better describe the conditions under which the Proposed Rule would reduce deadweight loss in the labor market

DOL also claims that the Proposed Rule will lead to cost-savings by reducing deadweight loss in the labor market.[53] According to the Department, "[m]inimum wages may prevent the market from reaching equilibrium and thus result in fewer hours worked than would otherwise be

---

[46] *See id*. at 53,968.
[47] 2017 Proposal, 82 Fed. Reg. at 57,408.
[48] *Id.*
[49] *See* Ctr. for Biological Diversity v. Nat'l Highway Traffic Safety Admin., 538 F.3d 1172, 1190, 1200 (9th Cir. 2008) (finding agency reasoning arbitrary and capricious where agency argued that benefits of carbon dioxide reductions were "too uncertain to support their explicit valuation and inclusion" in a regulatory cost-benefit analysis).
[50] *See* Oz Shy, *Do Tips Increase Workers' Income?*, 61 MGMT. SCI. 2041, 2042 (2015) (indicating that most studies have found no correlation or only a small correlation between service quality and tipping).
[51] *See* Ofer H. Azar, *The Social Norm of Tipping: Does it Improve Social Welfare?*, 85 J. ECON. 141 (2005). Note that Azar provides a theoretical model for how tipping may affect service quality but does not include empirical data.
[52] The market failure identified by Azar, *id*., is related to service quality rather than the relative pay of different staff members in the labor market, but to the extent that nontraditional tip pooling affects the perception of "fairness" inherent in the social norm, a negative effect could materialize.
[53] *See* 2019 Proposed Rule, 84 Fed. Reg. at 53,972.

efficient."[54] By allowing nontraditional tip pools, DOL argues, the Proposed Rule "may cause a shift in the labor demand and/or supply curves . . . [that] could result in the market moving closer to the competitive equilibrium."[55] But the Department neither quantifies the size of this potential reduction in deadweight loss nor adequately explains the range of assumptions that underlie its qualitative claim.

Even assuming for the sake of argument that the labor market for restaurants is perfectly competitive, it is not clear from the information provided that the Proposed Rule would result in a decrease in deadweight loss. If the minimum wage for *front-of-the-house* staff were above the market-clearing price, employers already have the option of avoiding that constraint by taking a tip credit. And if the minimum wage for *back-of-the-house* staff is above the market-clearing price, the Proposed Rule does not address that problem, because it does not enable employers to reduce wages for non-tipped staff below the minimum, even if those non-tipped workers participate in a nontraditional tip pool. Thus, DOL must better explain the circumstances under which it believes that instituting nontraditional tip pools will reduce deadweight loss.

Moreover, economists generally recognize that the restaurant industry is not a perfectly competitive market.[56] In fact, some believe that this labor market may be monopsonist.[57] In a monopsonist market, the buyer (in this case, the employer) sets the price artificially low, resulting in an inefficient market equilibrium. A minimum wage potentially fixes the distortion, at least partially, but if the market remains monopsonist and the minimum wage is set too low, "small increases in the minimum wage can increase both employment and earnings of affected workers."[58] In such a scenario, allowing employers to indirectly capture some of their employees' tips, as the Proposed Rule does, would actually increase deadweight loss, because it would cause tipped workers' total compensation to be pushed even further below the optimal level. The Department should thus either revise its deadweight loss analysis to address the Proposed Rule's effects in a monopsonist market or, in the alternative, explain why it believes the restaurant-labor market is not monopsonist.

---

[54] *Id.*
[55] *Id.*
[56] *See, e.g.*, Cosman, *supra* note 33.
[57] *See* David Card & Alan B. Krueger, *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania*, 84(4) AM. ECON. REV. 772, 791 (1994). *See generally* William M. Boal & Michael R. Ransom, *Monopsony in the Labor Market*, 35 J. ECON. LIT. 86 (1997). *But see* Daniel Aaronson, Eric French & James MacDonald, *The Minimum Wage, Restaurant Prices, and Labor Market Structure*, 43(3) J. HUM. RESOURCES 690 (2008) (finding that the empirical response to a minimum wage hike is more comparable to a competitive market model, but recognizing that the "results do not necessarily prove that labor markets are competitive" and that "positive comovement between the minimum wage and prices may be consistent with the monopsony model" if the minimum wage is set high enough).
[58] *See* William E. Even & David A. Macpherson, *The Effect of the Tipped Minimum Wage on Employees in the U.S. Restaurant Industry*, 80(3) SOUTHERN ECON. J. 633, 635 (2014).

Respectfully submitted,

Isabel Carey
Laura Figueroa
Jack Lienke
Julia Paranyuk
Jason A. Schwartz

Institute for Policy Integrity,
New York University School of Law
isabel.carey@nyu.edu