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SUBJECT: Minimum Wage Ordinance and CA Labor Code Section 351

A. Issue

The California Restaurant Association has asked us for a short legal memorandum explaining why section 351 of the California Labor Code as interpreted by *Henning v. Industrial Wage Commission (IWC)*, 46 Cal.3d 1262 (1988)[1], does not prohibit a proposed minimum wage ordinance based on the "total compensation" model (PMWO"). The CRA has also asked us to address the July 9, 2014 memorandum from the San Diego City Attorney to Mark Kersey.

B. Short Answer

Henning and Labor Code 351 are not applicable to the PMWO or similar ballot initiatives or ordinances based on a total compensation model. The July 9, 2014 memorandum from Jan Goldsmith to Mark Kersey offers nothing contradicting the opinions expressed in this memorandum. The Goldsmith memorandum does not address the total compensation model and is focused on a proposed ordinance with a *direct* tip credit opining that Labor Code "Section 351 likely prohibits a charter city from enacting a local minimum wage ordinance that permits employers to use a tip credit to supplement the difference between state and local minimum

[1] A copy of this opinion is available at http://login.findlaw.com/scripts/callaw?dest=ca/cal3d/46/1262.html

wage obligations of tipped employees." Goldsmith Memo at p. 10. Nevertheless, in the very next sentence Goldsmith opines: "However, beyond a direct tip credit, it is unclear whether Section 351 prohibits other alternatives such as a two-tiered minimum wage ordinance, total compensation model or exemption for tipped employees." Goldsmith Memo at p. 10.

C. Labor Code 351 and *Henning v. IWC*

California law/Labor Code 351 does not expressly prohibit laws, ordinances or regulations of any type. That statute governs the acts of employers and their agents and provides:

> 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.

In *Henning*, the California Supreme Court of California addressed the issue of whether the IWC "two-tier" state minimum wage system containing a lower, alternative state minimum wage for certain employees who customarily receive tips, is barred by Labor Code§ 351. Under the IWC "two-tier" system, the IWC had instituted a system by which there were two separate minimum wages: one minimum wage for tipped employees and a second higher minimum wage for non-tipped employees. More specifically, the Court in *Henning* determined whether tipped employees could be subject to a lesser state minimum wage of $3.50 per hour instead of the new minimum wage of $4.25 per hour.

In reaching its holding, the California Supreme Court analyzed the legislative history and construction of § 351. The Court explained that the Legislature 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. The *Henning* Court looked very closely at the legislative history of several bills. It looked most closely at Assemblyman Leroy Greene's AB 232 from the 1975-1976 legislative session,

which was the immediate source of section 351. The Court cited a memorandum by the Senate Committee on Industrial Relations in articulating the purpose and intended effect of section 351. The Court held that, consistent with the legislative history, the purpose of the bill was "[t]o eliminate the authority of the Industrial Welfare Commission to permit employees to credit tips against the wages of employees." *Id.* at 1275. The Court went on to explain that the bill was specifically intended "to require employers to pay employees at least the minimum wage regardless of the amount of tips the employees receive." *Id.* at 1275 and 1279.

In holding that the IWC's two-tiered minimum wage of $3.50 for tipped employees and $4.25 for untipped employees was a violation of section 351, the California Supreme Court also found it significant that for many years (at least between 1976 and 1984), the IWC itself had found that section 351 and its legislative history revoked the IWC's authority to "establish a lower cash minimum wage for tipped employees" *Id.* at 1276.

In ruling that the two-tiered minimum wage system adopted by the IWC in 1987 was a violation of section 351, the California Supreme Court was careful to limit its holding to the restrictions placed by the legislative history on the IWC and the prohibition of only a two-tiered wage. The Court stated that "the IWC is generally not required to fix a single minimum wage for all employees. . We cannot agree however that section 351 does not bar the 'two-tier' minimum wage system at issue here." *Id.* at 1277.

D. Application of 351 and *Henning* to Proposed Minimum Wage Ordinance.

1. Structure of the PMWO

The PMWO being proposed by CRA is markedly different than the two-tiered IWC system in *Henning* that paid one wage for non-tipped employee and another lower wage to tipped employees. The PMWO requires the same locally-mandated minimum wage to be paid to all covered employees, regardless of whether they receive tips or not. There is no tip credit against the minimum wage. In addition, the PMWO institutes minimum wage requirements that are greater than the state-mandated minimum wage and was not designed to replace or supersede state (or federal) minimum wage requirements. More specifically, under the PMWO all covered employees, regardless of whether they receive tips or not, will be required to receive a minimum wage as follows, regardless of whether they receive tips or not:

YEAR	MINIMUM WAGE
January 1, 2015	Equivalent to $__.00/hour
January 1, 2016	Equivalent to $__.00/hour

January 1, 2017 Equivalent to $__.00/hour

The PMWO does not utilize a tip credit at all. There is no mention of a tip credit in the initiative at all. In fact, the only time anything even remotely similar is mentioned is when the initiative indicates that gratuities are considered taxable under state law for purposes of determining the higher earner exception to its coverage.[2] The drafters of the PMWO considered that employees who are already being compensated based on performance and in a gross amount that is at least equal to $__ per hour, on average over the course of the previous calendar year or some other measurable time period, does not need the full protections of the PMWO. Therefore, the PMWO provides that certain employees whose overall state taxable income averages greater than $__.00 an hour are higher earners and do not need to be covered by the PMWO because they already receive a reasonable amount of total taxable income. Of course, tips/gratuities are only one of many types of income that our state considers when determining taxable income.

2. Analysis of PMWO under *Henning*

Because of the way it is structured, as a single-tier minimum wage for all covered employees that always requires wages be paid at or greater than the state minimum wage, the PMWO does not violate Labor Code section 351 and is entirely distinguishable from the California Supreme Court holding in *Henning.* The specific reasons for this can best be explained as follows:

i. The PMWO Is Not Two-Tiered

The PMWO is entirely distinguishable from *Henning* because it does not involve a two-tiered wage for tipped and non-tipped employees or a tip credit, whereby tipped employees are permitted to have a lower minimum wage than non-tipped employees. The *Henning* Court held that the IWC could not implement a "two-tiered minimum wage system" by which tipped employees have a lower minimum wage than non-tipped employees because of Labor Code 351. The PMWO does not attempt to implement such a system. Under the PMWO all covered employees are subject to the same minimum wage regardless of whether they receive tips or not and therefore section 351 and *Henning* are not applicable.

[2] It is important to note, that the words "tips" and/or "gratuities" need not even be mentioned in the PMWO initiative. They are entirely unnecessary and eliminating their reference from the ballot measure would not in any way change the meaning or effect of the proposal. The term "tips" is not used in the PMWO at all. The term "gratuities" is mentioned only to explain that they are part of taxable income in California.

ii. The PMWO is Not a State or IWC Regulation

The *Henning* case focused largely on the legislative history of section 351 and the language in there that it claimed expressly prohibited the IWC from allowing tipped employees to receive a minimum wage lower than the state minimum wage for non-tipped employees. There is nothing indicated in the legislative history of section 351 that in any way prohibits a municipality, from adopting regulations of the minimum wage that are separate from the state minimum wage and somehow include tips as part of the calculation. The legislative history that was so heavily relied on by the *Henning* court only addresses the IWC's latitude to adopt a base state minimum wage and thus section 351 is not applicable to an ordinance (or ballot initiative) governing wages within a given municipality.

iii. All Employees Are Still Subject to the Federal and State Minimum Wage

There is no contention that the PMWO preempts or in any way restricts the application of the federal and state minimum wage. In fact, section 7 makes it clear that there is no preemption and that all employees in the municipality, whether covered by the PMWO or not, must still be paid wages that are equal to or exceed the federal and California minimum wage laws and regulations. The IWC minimum wage order remains applicable to all employees. According to *Henning,* the intended effect of section 351 and its restrictions on the IWC was to "require employers to pay employees at least the minimum wage regardless of the amount of tips the employees receive." Nothing in the PMWO in any way eliminates this requirement. All employees will always receive wages at or greater than both the state and federal minimum wage.

iv. The Exemption for Higher Paid Employees is Not Prohibited

There is nothing in section 351 or in *Henning* that prohibits a municipality from adopting minimum pay standards, above the state minimum wage, for only certain employees. Here, the obvious intent of the PMWO is to raise the wages of certain employees within the municipality. More specifically, the intent is to raise the wages of certain lower paid employees not working for certain smaller employers and charitable organizations within the city to a base rate of $10.10 per hour and then gradually to rates higher than that. In addition, the intent of the initiative is to utilize these rates for those employees that need it the most, i.e., those employees who are not taking home, on average, taxable earnings of at least $__ an hour, before overtime. The fact that gratuities are one of many elements used to measure state taxable earnings is inconsequential. Labor Code 351 prohibits a tip credit. It does not prohibit municipalities from deciding the scope of their wage regulations, particularly in this situation, where no tip credit is utilized and all covered employees are subject to the same wage regulation regardless of whether they are tipped employees or non-tipped employees. In fact,

Henning even contemplated minimum wage regulation for only certain employees as it expressly held that section 351 was not intended to require "a single minimum wage for all employees." *Id.* at 1277.

In sum, the PMWO and any municipal ordinance or ballot initiative based on the same principles, is wholly distinguishable from the holding in *Henning* and is not in any way a violation of section 351 of the California Labor Code. There is nothing in section 351, its legislative history, or *Henning* that prohibits a municipality, through voter initiative or city council adoption, from implementing a single-tier minimum wage that (a) is greater and wholly separate from the state minimum wage, (b) covers only some employers and certain employees working for those employers, and (c) requires the same minimum wage be paid to tipped and untipped employees.

E. The Goldsmith Memorandum Does Not Contradict The Conclusions of This Memorandum

In July 2014, Jan Goldsmith, city attorney for San Diego issued a ten page memorandum addressing local minimum wage ordinances under Section 351 and *Henning.* We understand that certain people are citing Goldsmith's memo to support a position that a PMWO under a total compensation model is barred by section 351 and that Goldsmith supports this position. This interpretation is grossly flawed in our opinion and any basic reading of the Goldsmith memo demonstrates that this is not in fact Goldsmith's opinion. Goldsmith never reached any such conclusion.

1.. Goldsmith Does Not Even Definitively Say That an Ordinance With an Express Direct Tip Credit Is Invalid

The only thing that Goldsmith opined was "likely" prohibited by Section 351 was a minimum wage ordinance that utilizes a direct tip credit model, which means an ordinance that expressly permits employers "to use a tip credit to supplement the difference between state and local minimum wage obligations to tipped employees." In fact, Goldsmith was not even able to say that such a local ordinance, offering a direct tip credit, was definitely invalid and his memo offers at least two ways that Section 351 and *Henning* may be interpreted to actually allow a local ordinance containing a direct tip credit.

First, Goldsmith correctly points that the courts have only interpreted section 351 as it relates to statewide statutes and "have not offered any guidance on the interplay between Section 351 and a local minimum wage ordinance." Goldsmith memo at p. 4. Goldsmith also found that, based on this fact, the courts may end up offering a narrow interpretation of section 351 and *Henning*, that would provide that even a city enacted "local minimum wage that includes a tip credit may not contradict or conflict with Section 351." He states that if a court adopted the narrow interpretation, which is entirely possible, "Section 351

may have no impact on a local minimum wage. This would leave municipalities with free reign to enact local minimum wage legislation that excluded tipped employees (in any manner), so long as these tipped employees still earned state minimum wage." Goldsmith memo at p. 4. This is consistent with my conclusion as well (see D.2.ii above).

In addition, Goldsmith also analyzed the legislative history of section 351 and concluded that Section 351 might also be reasonably interpreted to allow regulations that merely "require employers to pay employees *at least the minimum wage* regardless of the mount of tips the employees receive." Goldsmith memo at p. 4. In other words, direct tip credits would be permissible as long as the employee earns a wage that is in excess of the state minimum wage. Goldsmith explained that the "legislative history suggests that the Section 351 could be interpreted narrowly to prohibit a *state* agency (the IWC) from enacting any regulation or law that would allow employers to use a tip credit to pay a tipped employee a wage lower than the *state* minimum wage." Goldsmith memo at p. 4

In sum, I find it hard to understand how anyone could state that Goldsmith believes that a total compensation model is illegal under section 351, when Goldsmith does not even equivocally state that a direct tip credit is illegal and offers several ways in which 351 could be interpreted to expressly permit a local minimum wage ordinance with a direct tip credit.

2. Goldsmith Reaches No Conclusion About Total Compensation Model Other Than He Does Not Know How It Will Come Out

Goldsmith's memo after analyzing how Section 351 might be interpreted with respect to local legislation providing for a direct tip credit, expressly recognizes that there are many other local alternatives besides a direct tip credit. "[T]here are other local minimum wage alternatives to a tip credit, including a two-tiered wage ordinance, total compensation model or an outright exemption for tipped employees." Goldsmith memo at p. 6. However, Goldsmith's memo did not hide his conclusion related to these alternatives. He set forth his opinion on the total compensation model in both the introduction and conclusion of his paper, stating 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 exemption for tipped employees" Goldsmith memo at pp. 2 and 10.

Thus, anyone who cites the Goldsmith memo for the position that Goldsmith believes that Section 351 prohibits a local minimum wage ordinance based on a total compensation memo is simply ignoring Goldsmith's express opinion set forth equivocally several times in the memorandum that Goldsmith has no idea how the courts would interpret such an ordinance under 351 and *Henning.*