Morgan Lewis

did you know?

retail

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Dear Retail Clients and Friends,

On November 22, the U.S. District Court for the Southern District of New York issued its ruling *in Maldonado v. BTB Events & Celebrations, Inc.*,[1] holding that a mandatory 11% surcharge added to catering bills was not a "tip" under the Fair Labor Standards Act (FLSA) and was not a tip under the New York Labor Law (NYLL) prior to January 1, 2011. However, since January 1, 2011, New York employers have been required to show, by clear and convincing evidence, that they provided sufficient notice for reasonable customers to understand that specific charges are not gratuities. This edition of ***Morgan Lewis Retail Did You Know?*** describes the court's decision and its potential application to your company.

Background

For purposes of the FLSA, regulations issued by the Department of Labor (DOL) define a "tip" as "a sum presented by a customer as a gift or gratuity in recognition of some service performed for him."[2] "Whether a tip is given, and its amount, are matters determined solely by the customer, who has the right to determine who shall be the recipient of the gratuity."[3]

Unlike the FLSA, section 196-d of the NYLL provides that "[n]o employer or his agent or an officer or agent of any corporation, or any other person shall demand or accept, directly or indirectly, any part of the gratuities, received by an employee, or retain any part of a gratuity or of any charge purported to be a gratuity for an employee."

Whether "a mandatory charge or fee is purported to be a gratuity" will "be weighed against the expectation of the reasonable customer."[4] In 2010, the New York State Department of Labor (NYSDOL) issued a nonexhaustive list of factors that bear on whether a reasonable customer would believe a particular service charge is a gratuity. These factors include the font size and prominence of the notice, whether the purpose of the charge and manner of calculation are included on the bill, and whether there is a separate line for gratuity.

Unwilling to rely on the nonexhaustive list of factors that would be looked at in the totality of a particular situation, the NYSDOL promulgated additional regulations that took effect on January 1, 2011 (the 2011 Regulations). The 2011 Regulations create "a rebuttable presumption that any charge in addition to charges for food, beverage, lodging, and other specified materials or services, including but not limited to any charge for 'service' or 'food service,' is a charge purported to be a gratuity."[5]

Maldonado Holding

Presented with a catering company's 11% "servicing charge," which later became known as a "processing charge," Judge Paul A. Engelmayer of the Southern District of New York considered whether the charge was a tip under federal and New York state law. The plaintiffs—nine employees who made catering deliveries between 2006 and 2012—alleged that the servicing charge was a tip and the company violated the FLSA and the NYLL by withholding a portion of the charge from the plaintiffs. The defendants claimed that their withholding did not violate

1. No. 12 Civ. 5968 (PAE), 2013 WL 6147803 (S.D.N.Y. Nov. 22, 2013).
2. 29 C.F.R. § 531.52.
3. *Id.*
4. *Samiento v. World Yacht Inc.*, 883 N.E.2d 990, 994 (N.Y. 2008).
5. N.Y. Comp. Codes R. Regs. tit. 12, § 146-2.18(b).

either law because the charge was not a gratuity. The mandatory servicing charge in question was assessed on delivery orders placed over the phone and was based on the total food and drink bill before taxes were added. No written explanation of the charge was provided on the order invoice, and, if asked, delivery personnel told customers to contact the catering company's management. Significantly, the invoices also included a line for "gratuity."

Ruling on cross-motions for partial summary judgment, Judge Engelmayer concluded that the processing/servicing charge could not be deemed a tip under the FLSA because, "as a matter of law, a mandatory charge cannot constitute a 'tip' for the purposes of the FLSA."[6] This analysis would apply even if some of the amounts collected were distributed to the employees.

Turning to the cross-motions for summary judgment under the NYLL, Judge Engelmayer's decision was split and depended on the dates of the catering orders. For the period prior to January 1, 2011, the judge focused on whether a reasonable customer would understand that the servicing charge was a gratuity for an employee. Looking at all of the factors, including the placement of the surcharge (above the line for taxes) and the separate line for gratuities (which 75% of customers used), the court was persuaded that a reasonable customer would not regard the charge as a gratuity. Summary judgment was entered in favor of the employer on its partial motion.

Although the servicing charge was deemed to not be a tip for orders before January 1, 2011, the circumstances surrounding the charge failed to satisfy the rebuttable presumption in the 2011 Regulations. The court noted that, while the regulations did not change the mode of analysis, they placed a greater onus on the employer. Indeed, the regulations now require (1) that an administrative charge "shall be clearly identified as such and customers shall be notified that the charge is not a gratuity or tip"; (2) that "[t]he employer has the burden of demonstrating, by clear and convincing evidence, that the notification was sufficient to ensure that a reasonable customer would understand that such charge was not purported to be a gratuity"; and (3) that "[a]dequate notification shall include a statement in the contract with the customer, and on any menu or bill listing prices, that the administrative charge is for administration of the banquet, special function, or package deal, is not purported to be a gratuity, and will not be distributed as gratuities to the employees who provided service."[7]

Practical Implications

New York employers that operate in the restaurant, food service, and catering industries should ensure that any administrative charges are overtly and unmistakably designated in accordance with the regulatory language. Restaurant and catering operators operating in other states must know the various state requirements and should monitor any changes in regulatory guidance.

Contacts

If we can be of assistance to you in these matters, please feel free to get in touch with your Morgan Lewis contact or any of our Retail Practice leaders:

Anne Marie Estevez, Labor & Employment
Miami
305.415.3330
aestevez@morganlewis.com

Greg Parks, Litigation
Philadelphia
215.963.5170
gparks@morganlewis.com

6. *Maldonado*, No. 12 Civ. 5968 (PAE), 2013 WL 6147803, at *5.
7. N.Y. Comp Codes R. Regs. tit. 12, §§ 146-2.19(a)–(c).

Morgan Lewis

Lisa Stephanian Burton, Labor & Employment
Boston
617.341.7725
lburton@morganlewis.com

Michael J. Puma, Labor & Employment
Philadelphia
215.963.5305
mpuma@morganlewis.com

Christopher A. Parlo, Labor & Employment
New York
212.309.6062
cparlo@morganlewis.com

These individuals are part of our international Retail Practice. Lawyers from our 25 offices regularly represent national, regional, and local retailers in a broad array of subject matters including litigation, labor and employment, real estate, tax, transactional, and regulatory.

About *Morgan Lewis Retail Did You Know?*

This message is part of our effort to educate our retail clients and friends about important legal developments. One thing we hear frequently from our retail clients is that it is hard to keep track of new and emerging laws and lawsuit trends that affect retailers. All too frequently, the first notice comes in the form of a lawsuit seeking millions of dollars. To help you be more proactive in managing legal compliance, we are providing these emails.

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