Published on *The National Law Review* https://natlawreview.com

Time Is Money: A Quick Wage-Hour Tip on … Ensuring You Don't Inadvertently Convert Mandatory Charges into Gratuities for Staff

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Employment, Labor, Workforce Management

Many employers may—understandably—view gratuities as ***discretionary*** payments that customers leave in exchange for superior service. After all, federal wage and hour regulations define "tips" as "sum[s] presented by a customer as a ***gift*** or gratuity in recognition of some service performed." 29 C.F.R. § 531.52 (emphasis supplied). The regulations also state that "***compulsory*** charge[s] for service" are ***not*** tips. 29 C.F.R. § 531.55 (emphasis supplied).

But in some cases, a ***mandatory*** charge may qualify as a tip that employers must distribute to staff under state or local law.

By way of example, employers in the hospitality industry commonly assess mandatory "service" or "administrative" charges in connection with the administration of catered events, such as receptions and conferences. Depending on, among other things, the disclosures that the employers make to their customers, employees who provide services during the events may argue that state and/or local law requires their employers to distribute those charges to staff.

New York State is a prime (but not the only) example of a jurisdiction where this issue can arise.

In New York, employers cannot retain a gratuity or any "charge ***purport[ing] to be a gratuity*** for an employee." NYLL § 196-d (emphasis supplied). Compulsory charges can qualify as charges "purporting to be a gratuity" if an employer represents or allows "customers to believe that the charges were in fact gratuities for their employees." *Samiento v. World Yacht Inc.*, 10 N.Y.3d 70, 81 (2008). Whether a mandatory charge purports to be a gratuity within the meaning of NYLL § 196-d turns on a holistic assessment of how a "reasonable customer" would understand the charge. *Maldonado v. BTB Events & Celebrations, Inc.*, 990 F. Supp. 2d 382, 389 (S.D.N.Y. 2013).

In other words, if a reasonable customer would view a mandatory charge as a gratuity for staff—thereby theoretically reducing the likelihood that the customer would also provide a discretionary tip—the employer cannot retain it.

Notably, New York's Hospitality Industry Wage Order creates a rebuttable presumption in the hospitality industry 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 purport[ing] to be a gratuity." N.Y. Comp. Codes R. & Regs. tit. 12, § 146-2.18.

The Wage Order also includes provisions specifically relating to charges associated with the administration of banquets and special functions, such as catered events. More specifically, the Wage Order states that employers must notify customers that such charges are *not* gratuities. N.Y. Comp. Codes R. & Regs. tit. 12, § 146-2.19. Under the Wage Order, adequate notification that such a charge is not a gratuity "shall include a statement in the contract or agreement with the customer, and on any menu and 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 to the guests." *Id*. In addition, the disclaimers must use "ordinary language readily understood … in a font size similar to surrounding text, but no smaller than a 12-point font." *Id*.

Class action lawsuits filed by employees seeking to recover mandatory charges under New York's tip misappropriation law are common, and the lawsuits are not always limited to employers in the hospitality industry, or to service charges assessed in connection with banquets and special functions. Plaintiffs working as delivery drivers, for example, have filed lawsuits claiming that they are entitled to recover proceeds from "delivery fees" and similar charges associated with grocery delivery. Moreover, as stated above, New York State is not the only jurisdiction where these kinds of claims might arise.

Minnesota law, for example, defines "gratuities" as "monetary contributions received directly or indirectly by an employee … and includes an ***obligatory charge*** assessed to customers … which ***might reasonably be construed*** … as being a payment for personal services rendered by an employee and for which ***no clear and conspicuous notice is given*** by the employer … that the charge is not the property of the employee." Minn. Statutes § 177.23, subd. 9 (emphasis supplied).

In addition, in 2019, a California Court of Appeal held that a mandatory service charge could potentially qualify as a gratuity under California Labor Code § 351, which prohibits employers from receiving "any gratuity or a part thereof that is paid, given to, or left for an employee by a patron." *See O'Grady v. Merchant Exchange Productions, Inc.*, 41 Cal. App. 5th 771, 790 (2019) (noting, among other things, that the "purpose [of Labor Code § 351] would not be served by allowing employers to take money intended for employees simply by saying the customer has paid a 'service charge'").

Finally, this issue also extends beyond an employer's relationship with its employees. Indeed, if a business fails to provide appropriate disclosures to its customers about certain kinds of mandatory charges, the charges may implicate consumer protection laws designed to protect consumers against fraudulent and misleading business practices.

So how can employers ensure that they do not inadvertently convert a mandatory charge into a gratuity for staff?

As a general matter, clear and consistent communication to customers about the purpose of the charge is key. In addition, depending upon, among other things, the jurisdiction, industry, and nature of the charge, employees may argue that their employers are required to include disclaimers to customers in multiple different documents, using specific language, and a specific font size.

Given these intricacies, and the significant exposure that can arise in tip misappropriation (and consumer protection) class actions, employers should carefully evaluate whether any mandatory charges they impose on customers could be construed as gratuities, and whether, and in what manner, state and/or local law obligates them to notify customers that the charges are not gratuities for staff.

National Law Review, Volume X, Number 273