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A PRIMER FOR RESTAURANT EMPLOYERS REGARDING WAGE LAWS SPECIFIC TO THE RESTAURANT INDUSTRY

Lawsuits against restaurants for violations of labor laws are on the rise. Among the most common claims against restaurants is that restaurant owners owe unpaid tip compensation or overtime compensation to their employees under federal or state laws. While restaurant owners are potentially liable for overtime compensation to all of their employees, tipped employees (e.g., servers) have specific, and complex, overtime compensation and tip compensation rules.

Restaurant owners need to be aware of how the Fair Labor Standards Acts (“FLSA”) and local labor laws impact their responsibility to compensate tipped employees for both their tips and for overtime work, which the FLSA defines as work in excess of 40 hours per week. Restaurant owners also need to be aware of how certain other provisions of labor laws can affect restaurant owners’ liability with regard to certain unpaid wage claims. Below, we highlight some of the key areas that should concern restaurants under the FLSA and New York labor law with respect to liability to tipped employees. This primer is meant only to highlight and briefly explain the defenses to potential violations of labor laws. Any restaurants accused of violating these laws should consult experience counsel. If you have questions, please do not hesitate to call or e-mail Michael Anania (212-269-4900/mlania@fmew.com) or Adam Cassady (212-269-4900/ascassady@fmew.com).

WHICH RESTAURANTS ARE SUBJECT TO FLSA WAGE REGULATIONS?

According to the United States Department of Labor, both restaurants and fast food eateries, defined as “establishments which are primarily engaged in selling and serving to purchasers prepared food and beverages for consumption on or off the premises,” are subject to overtime regulations under the FLSA so long as the business has annual gross sales that total at least \$500,000 from one or more locations. If your restaurant business meets this definition, you are potentially subject to FLSA overtime regulations.

WHICH RESTAURANTS ARE SUBJECT TO NEW YORK WAGE REGULATIONS?

Under New York State labor law, “every employer in the restaurant industry” is subject to both minimum wage and overtime regulations. Restaurants include “any eating or drinking place that prepares and offers food or beverage for human consumption either on any of its premises or by such service as catering, banquet, box lunch, curb service or counter service to the public, to employees, or to members or guests of members, and services in connection therewith or incidental thereto.” So, for example, whereas ordinarily a ‘restaurant’ may not be understood to be a private dining

room in a members' club, under New York law, it would be.

WHO IS A TIPPED EMPLOYEE?

Under the FLSA, tipped employees are those "who customarily and regularly receive more than \$30 per month in tips." Those tips are the property of the employee. Under New York law, tipped employees at restaurants include "wait staff, bartenders, captains and bussing personnel . . . who regularly receive tips . . . [but do] not include delivery workers."

WHAT ARE THE FLSA WAGE RULES FOR TIPPED EMPLOYEES?

Generally speaking, tips are the property of the employee. Employers are prohibited from using employees' tips for any reason other than as a credit against its minimum wage obligation. All tip transactions between tipped employees and customers must be handled exclusively by tipped employees.

Under the FLSA, any tipped employee must be paid at least \$2.13 per hour. If an employer wishes to retain any portion of the tips earned by tipped employees as a credit against its minimum wage obligations, it may retain only so much as is necessary to ensure that the tipped employee receives at least minimum wage—that is, the maximum amount of 'tip credit' a restaurant may claim is \$5.12 per hour (\$7.25 per hour minimum wage less the \$2.13 per hour cash wage owed).

An employer may retain the 'tip credit' to itself either as part of a collective tip sharing/pooling arrangement, or on an individual basis. In no case, however, may any tipped employee's wage drop below \$7.25 per hour after all tips have been credited to that employee. If it does, the employer is liable for the difference.

For instance, if a tipped employee such as a server works overtime—that is, in excess of 40 hours per week—his employer will owe him, under the FLSA, 1.5 times the minimum wage less the tip credit. So the restaurant owner would owe $\$7.25 \times 1.5 = \$10.88 - \$5.12 = \5.76 for every hour of overtime worked, assuming that the restaurant owner took the maximum tip

credit. If the tips paid to the overtime server during overtime hours were adequate to make up the \$5.12 per hour tip credit, the owner may not claim a credit on any tips above that amount. If the tips are not adequate to total \$10.88 per hour, the owner must make up the difference.

Failure to pay adequate overtime wages, or claiming too much tip credit, can subject a restaurant owner to liability. Moreover, the FLSA provides that employers, including restaurant owners, of tipped employees must disclose to those employees several specific details about tip crediting and tip pooling; it is, therefore, essential for any restaurant owner to diligently follow these rules, as violations can serve as a basis for liability even when employees were actually paid everything they were owed.

WHAT ARE THE NEW YORK WAGE RULES FOR TIPPED EMPLOYEES?

Under the New York State labor law, there are special rules pertaining specifically to tipped *food service* workers, defined as "any employee who is primarily engaged in the serving of food or beverages to guests, patrons or customers in the hospitality industry, that are somewhat different from tipped employees generally. Tipped food service workers must be paid at least \$5.00 per hour, and a restaurant owner may not claim a tip credit of greater than \$2.25 per hour. The minimum a food service employee must receive under New York labor law is \$7.25 an hour. As is clear, a restaurant owner is responsible for providing much more of the minimum wage owed to a tipped employee under New York law than under federal law, because the restaurant owner is only entitled to a tip credit of \$2.25 rather than \$5.12. Attempting to take the full federal credit would subject a New York restaurant owner to liability.

New York law too requires overtime to be paid to employees working in excess of 40 hours per week. A non-tipped restaurant employee will be entitled to at least 1.5x his hourly wage for every hour worked over 40 per week. A tipped employee will be owed at least 1.5x, his minimum wage (\$10.88) less a \$2.25 per hour tip credit—assuming the employee earns at least \$2.25 per hour in tips—for a total of \$8.63

per hour. This is significantly more than is owed under the FLSA, due to the smaller New York tip credit. If the tipped employee earns less than \$2.25 per hour in tips, the employer must make up the difference to arrive at a total of \$10.88 per hour.

Also as under the FLSA, New York law has specific reporting and bookkeeping requirements that a restaurant owner must follow regarding tip pooling and sharing arrangements. Because failure to meet these requirements can subject a restaurant owner to liability, owners should be diligent in maintaining their records and accurately reporting to employees.

HOW DOES TIP POOLING AFFECT RESTAURANT LIABILITY?

Tip pooling and sharing is permissible under both the FLSA and New York law.

Under the FLSA, a restaurant owner may permit (though it may not require) its employees to participate in a tip pooling or sharing arrangement. This arrangement may permit all employees who are customarily tipped employees to share tips among themselves, so long as the apportionment is fair. However, a restaurant owner may not require tipped employees to share their tips with employees who are *not* customarily tipped; e.g., cooks, chefs, janitors, and so on. (But neither may a restaurant owner pay those non-tipped employees anything less than minimum wage.) New York law has a few additional specific rules pertaining to tip pooling and sharing arrangements, but, as under the FLSA, an employer may set the percentages of the tip pool to be distributed to certain employees. Tip pooling or tip sharing participation among employees, however, must be voluntary.

HOW DO SERVICE CHARGES AFFECT RESTAURANT LIABILITY?

Under New York law, a restaurant owner may not retain any part of the gratuities customarily paid to tipped employees, including servers and other wait staff. Often, restaurants will add 'service charges' on a bill for a large party, which may not be intended to be paid to the wait staff as tips. However, if it is not clear to the

customer that this 'service charge' is not intended for the wait staff, the restaurant owner may incur liability to the wait staff if the service charge is not paid to them.

A recent New York statute provides that such service charges, when denominated as charges for 'service' or 'food service', are *presumed* to be a gratuity and must therefore be distributed to the wait staff. Restaurant owners may potentially be able to rebut this presumption by providing evidence that they communicated to their customers that the service charge was *not* intended as a gratuity, and thus the restaurant owner was entitled to retain the charge. However, because this may be difficult to prove, a restaurant owner seeking to retain service charges but avoid liability should denominate the charge as not intended as a gratuity for the wait staff, such as 'non-gratuity service charge'.

HOW DO CREDIT CARD PROCESSING FEES AFFECT RESTAURANT LIABILITY?

Under both the FLSA and New York law, an employer may deduct a pro-rated amount of a credit card processing fee for a tip to an employee charged to a credit card. For example, if a bill totals \$100 and a customer leaves \$120 (\$100 for the bill plus \$20 for a tip), and the credit card processor charges a 5% processing fee, the employer may not take the entire \$6 processing fee out of the employee's tip, but only 5% of the employee's tip (\$20), or \$1. Restaurant owners should be diligent in keeping records of credit card transactions to ensure that employees are only deducted a pro-rated processing fee charge from their tips.

HOW DO LONG DAYS (NOT OVERTIME) AFFECT RESTAURANT LIABILITY?

Under New York law, any restaurant employee (including a tipped employee) who works longer than a "spread" of ten hours in a day (even if the employee is not working during all of those hours) is entitled to an extra hour of minimum wage, in addition to the hours actually worked. So even if, for example, a server works a lunch shift of four hours and a longer dinner shift of only five hours with a two hour gap between the two shifts, the 'spread of hours' would be 11, and the restaurant worker would be entitled to

an extra hour at the minimum wage of \$7.25, on top of hours already worked and any overtime wages.

Of course, there are many more issues that a restaurant owner should be aware of, and each

of the issues discussed provides only an overview. If you have questions about whether your restaurant wage practices are adequate under federal or state law, please do not hesitate to contact us.

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