February 2008

CLIENT ALERTS

EPSTEIN BECKER & GREEN, P.C.

Resurgens Plaza
945 East Paces Ferry Road
Suite 2700
Atlanta, Georgia 30326-1380
404.923.9000

150 North Michigan Avenue
35th Floor
Chicago, Illinois 60601-7553
312.499.1400

Lincoln Plaza
500 N. Akard Street
Suite 2700
Dallas, Texas 75201-3306
214.397.4300

Wells Fargo Plaza
1000 Louisiana
Suite 5400
Houston, Texas 77002-5013
713.750.3100

1925 Century Park East
Suite 500
Los Angeles, California 90067-2506
310.556.8861

Wachovia Financial Center
200 South Biscayne Boulevard
Suite 4300
Miami, Florida 33131
305.982.1520

Two Gateway Center
12th Floor
Newark, New Jersey 07102-5003
973.642.1900

250 Park Avenue
New York, New York 10177-1211
212.351.4500

One California Street
26th Floor
San Francisco, California 94111-5427
415.398.3500

One Landmark Square
Suite 1800
Stamford, Connecticut 06901-2681
203.348.3737

1227 25th Street, N.W.
Suite 700
Washington, DC 20037-1175
202.861.0900

WWW.EBGLAW.COM

Anchors Away! Decision in World Yacht Sends 'Service Charges' Sailing

In its recent decision in *Samiento v. World Yacht, Inc.*, 2008 WL 382346 (Feb. 14, 2008), the New York Court of Appeals found that mandatory service charges, previously excluded from gratuity treatment pursuant to section 196-d of the New York Labor Law, may now be considered under the statute a gratuity that should not be retained by the employer. *World Yacht* revisits the Court's decision in *Bynog v. Cipriani Group*, 1 N.Y. 3d 193 (2003), where it left open the issue regarding whether an employer's retention of part of a "gratuity" for an employee applies only to a voluntary gratuity provided by a customer or whether it may also apply to a service charge held out as a substitute for a gratuity. Under *World Yacht*, unless the employer specifically communicates to patrons in advance that the employer intends to withhold all or a portion of the service charge from their wait staff and other service workers, all monies received by such establishments as service charges must be distributed to service employees. As set forth below, the ruling in *World Yacht* is likely to have a profound impact on the service and hospitality industries.

Under 196-d, "[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 party of a gratuity or of any charge purported to be a gratuity for an employee." The plaintiffs in *World Yacht* were former and present restaurant servers claiming that their employers, who offered patrons various dining cruises around New York harbor, improperly withheld money collected as either service charges, gratuities included within the ticket price, or gratuities automatically added to a ticket at the time of purchase. Given the language of the statute, as well as an express provision stating that the Labor Law § 196-d shall not be interpreted to affect "practices in connection with banquets and other special functions where a fixed percentage of the patron's bill is added for gratuities, which are distributed to employees, nor to the sharing of tips by a waiter with a busboy or similar employee," the issue before the Court was whether 196-d applied to only a voluntary gratuity or tip presented by a customer, or whether it may also apply to a service charge held out to a consumer as a substitute to a tip.

In finding that a service charge that is not a wholly voluntary payment may nonetheless be construed as a "charge purported to be a gratuity" under the statute, the Court interpreted the legislative intent of the term "gratuity" and the remedial nature of the Labor Law to construe such language liberally in favor of the employees. Accordingly, the Court held that even where a charge to a consumer is mandatory, if it has been represented to a consumer as compensation to an employer's wait staff in lieu of a gratuity, any claims of a violation of 196-d may fall within the protections afforded by the Labor Law. The determination as to whether a mandatory charge or fee is "purported to be a gratuity" shall be weighed against the expectation of a reasonable customer. If a reasonable customer believes that the service charge is a gratuity, the entire service charge must be distributed to the employees. Moreover, in furtherance of any such claims, the Court also found that plaintiffs may show the employer's tax treatment of the charges at issue since such charges, which are treated as gratuities for tax purposes, may also be represented to patrons as gratuities.

This ruling is of particular significance to any business enterprise that applies service charges to its customers. In order to avoid potential confusion and liability, employers should clearly communicate to their patrons that service charges are, in fact, separate from tips or gratuities. Thus, in those instances where an employer is seeking to maintain all or a portion of a service charge, employers are encouraged to include language on their receipts to inform patrons that a service charge does not represent a gratuity to the server and that additional gratuities customarily are added to the bill.

Alternatively, if an employer wishes to distribute the entire service charge to the employees, the employer should note that the service charge is a suggested or recommended amount, which may be changed at the discretion of the customer. By noting that the suggested or recommended amount may be changed at the customer's discretion, the gratuity retains its voluntary and non-mandatory nature – and appropriately should be distributed to the employees. When treated as a gratuity instead of a service charge, the employer would avoid the effect on the regular rate of pay, on increased overtime liability, as well as on sales tax.

By contrast, compulsory service charges (e.g., adding 15% to the bill) are not tips, and the Department of Labor considers them to be part of the employer's gross receipts for tax purposes. Where service charges are imposed and the employee receives no tips, the employer must pay the entire minimum wage and overtime (if applicable), as required by the Fair Labor Standards Act.

* * *

For further information on *World Yacht* or to address any questions that you might have, please contact Jay Krupin, Esq. at (202) 861-5333 or jpkrupin@ebglaw.com, or Frances Green, Esq., at (212) 351-4654 or fgreen@ebglaw.com. Special thanks to Eric Topel, Esq., and Richard Sloane, Esq., for their assistance with this Alert.