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Judge: Operator can use Ups to defray charge-card fee

Amy Spector

SANTA ANA, CALIF. -- A Superior Court judge here set the stage for an expected appeal by state labor officials by rejecting the regulators' efforts to stop a restaurant company from tapping servers' gratuities to pay charge-card fees levied on them.

Specialty Restaurants Corp., the Anaheim-based owner of 13 California dinner houses and 47 others nationwide, won the court decision this month after the state Division of Labor Standards Enforcement sued the company on behalf of servers at The Castaway restaurant in Burbank. Employees there were seeking nearly \$7,300 in charge-card fees deducted from their tips over an 18-month period ending in 1997.

Though subject to a "likely" appeal by the state, the court ruling could embolden other operators to begin deducting the proportional amounts of processing fees that credit card companies collect on tips charged by customers. Specialty Restaurants said its fees tied to charged tips are about \$70,000 annually in California alone.

However, some restaurant operators, mindful of labor shortages and the potential to alienate tip earners through such deductions, have indicated they are cautiously weighing the court ruling and the possibility of enacting fee-recovery policies.

Unlike the federal Fair Labor Standards Act, which allows employers to deduct service fees from employee tips, California's labor code prohibits such action, according to National Restaurant Association general counsel Peter Kilgore. He said the federal act includes a provision allowing state law to prevail over federal law where it benefits the employee, as in California.

Kilgore said he was unaware of any other state whose labor code restricted employers from withholding from gratuities the service fees linked to tips left by credit card users.

However, Orange County Superior Court Judge Frederick P Horn ruled that the state labor department had not interpreted the applicable code section correctly in cases involving charge-card processing costs, according to Specialty Restaurants' in-house counsel Ashley Baron. She said Specialty was recovering a fee, not taking part of the gratuity.

California's labor commissioner receives about two complaints each year. "all involving employers improperly taking employees tips." according to Miles Locker, chief counsel for the state agency. He said previous lawsuits concerning labor code infringements had been decided in trial courts, which do not set precedent and have no bearing on other courts. If the decision won this month by Specialty Restaurants is appealed by the labor department, which officials have termed very, very likely." the appellate court ruling would Net precedent I Locker said.

Locker alleged that Specialty Restaurants was as in violation of Labor Code Section 351, which he said prohibits employers from taking any part of a gratuity.

Specialty's lawyer, Baron, said the company began the practice ten years ago and did not profit from the transaction but only reduced tip pay-outs by amounts proportional to service fees on the gratuities. Those fees range from 1.69 percent to 2.8 percent of the total purchase, depending on the credit card used, Baron said.

At Specialty the calculations of charged-tip deductions are done by computer, and the employee is responsible for taxes only on

the net amount of the tip received, she said.

Locker alleged Specialty Restaurants had also violated Labor Code Section 2802, which he said prohibits employers from charging employees for the cost of running the business. Labor officials argued unsuccessfully in the Orange County case that the credit-card service charge was one of those costs, and that employees had no say in the restaurant's decision to accept charge cards.

Judith McMahon, vice president and general counsel for Specialty Restaurants, admitted its practice was rare in the industry but suggested that other companies had shied away from collecting the fees because they believed the procedure was illegal.

Labor officials had cited Specialty Restaurants repeatedly since 1989 for its charged-tip practice, according to McMahon. She said her response was always to cite a decision the labor board lost in 1981 over the same issue and had never appealed. That case involved the now-defunct Orange County restaurant Hemingway's.

McMahon said the recent lawsuit stemmed from the first citation the labor commissioner had made against her company in 10 years.

Locker said he was confident the decision would be overturned.

Operators react to court's decision on tip-fee recovery

While chief counsel Peter Kilgore of the National Restaurant Association said the practice of recouping charge-card fees from servers "is known within the industry" and that he receives calls regularly from restaurateurs asking about its legality, the procedure is rare in California.

Operators in The state who have raised questions about the issue with state labor officials and the California Restaurant Association said they have discouraged tip-fee recovery because it was considered illegal. The recent court ruling in favor of Specialty Restaurants Corp., however, has caused several local restaurateurs to rethink their strategy.

Craig Nickoloff, who estimated that his 24-unit Irvine-based Claim Jumper chain coughs up about \$300,000 annually in service fees on waiters' tips, said "I don't think we would take advantage [by collecting reimbursements]. We certainly don't want to upset the apple cart with our employees over what amounts to pennies individually."

In terms of a fee-recovery policy's unintended potential to encourage servers to request their tips in cash, Nickoloff expressed concern, saying, "The last thing I want a server doing is discussing tips with customers.

Gerhardt Tratter, director of operations at the Patina Group, chef Joachim Splichal's Los Angeles-based collection of fine-dining restaurants, also sounded a note of caution. "I would be concerned about losing a majority of very good employees to operations next door where they don't pass on charges," he said.

Will Karges, owner and operator of Blueberry restaurant in Santa Monica and the six-unit Johnnie's New York Pizza chain, said he would consider retrieving the fees from tipped employees because of the increasing cost of doing business. "There are so many things that hinder our ability to prosper," Karges said. "At the end of the day, servers who make very good money have to shoulder some of the responsibility," he added.

Sam King, president of Long Beach, Calif. -based King's Seafood Co., which operates the three-unit King's Fish House group and several critically acclaimed high-end restaurants in Los Angeles, also would consider recouping the fees, "but we wouldn't

be the first, second or third people to do it," he said. King said management would have to evaluate the fee's effect on crew morale: "Servers are the most instant-gratification people on the planet," he quipped.

King estimated that his company pays more than \$50,000 annually in fees on charged tips, most notably at its upper-end Water Grill, which processes as much as 89 percent of its business through charge cards.

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