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The Future of Tip Credit – And The Businesses That Depend Upon It

By J. Hagood Tighe and Karen Luchka (Columbia)

The U.S. Supreme Court is being asked to decide what amounts to the future of tip credit for many businesses – particularly in the hospitality industry. In short, the issue is whether an employer can continue to pay tip credit employees on a tip credit basis if they spend more than 20% of their work time on duties that did not produce tips.

Background

All employees must be paid the minimum wage under federal and state law. The FLSA allows employers to satisfy the minimum wage requirement by taking a "tip credit." For employees who regularly receive more than $30.00/month in tips, the tip credit provisions of the FLSA permit an employer to pay its tipped employees not less than $2.13 per hour in cash wages and take a "tip credit" equal to the difference between the cash wages paid and the federal minimum wage.

The tip credit may not exceed the amount of tips actually received and under the current minimum wage may not exceed $5.12/hour. Therefore, for example, under federal law an employer could pay a tipped employee $2.13/hr and take a tip credit of $5.12/hr, provided the tipped employee makes sufficient tips to cover the tip credit.

The use of tip credit, though simple in its concept, can also be complicated by state laws. Some states forbid the use of tip credit, while others impose significant recordkeeping and/or notice requirements on the use of tip credit.

The 20% Rule And *Applebee's*

On occasion, tipped employees are asked to perform duties that are not tip generating – such as rolling silverware, cleaning up at the end of the shift, etc. The law recognizes and permits tipped employees to perform some related non-tipped duties. But, federal law does not say how many "related non-tipped duties" an employee can perform and still be paid on a tip credit basis.

The U.S. Department of Labor has adopted the "20% rule." The DOL takes the position that an employer may not take a tip credit for time spent on non-tipped duties if the employees spend more than 20% of their time performing such non-tipped duties.

In 2007, a federal court in Missouri adopted the DOL's 20% rule in a class action potentially involving more than 40,000 current and former tipped employees of Applebee's. The U.S. Court of Appeals for the 8th Circuit agreed. The Court concluded that the employer could not apply tip credit to time tipped employees spent performing non-tipped duties if those duties exceeded 20% of the employee's work time. So, if an employee spent 70% of his time serving customers and 30% of his time doing other tasks such as cleaning the store or answering phones, an employer would have to pay the employee at least minimum wage for the 30% of the time spent doing non-tipped duties.

The Practical Impact

These decisions, if upheld, will require employers to keep very careful track of not only the time tipped employees spent working, but also what tasks they were performing during that time. Additionally, a likely outcome of the decision is that many employers would be forced to pay tipped employees at two different pay rates: one for time spent performing tipped duties and minimum wage (or higher) for time spent performing non-tipped duties.

The *Applebee's* decision is causing heartburn for many hospitality employers who fear they face a future of percentage calculations and multiple wage rates for tipped employees. The decision has wound its way up through the court system for the past few years and Applebee's has now asked the US Supreme Court to decide. If the Supreme Court adopts the 20% rule, the decision could cause many hospitality employers to reevaluate the use of tip credit for tipped employees at all. That would significantly alter the way employers maintain payroll records, compensate tipped employees, and manage their business. For some, there may be no choice but to close their doors – meaning these tipped employees will not be paid at all.

What To Do Now

High-profile class actions regarding the compensation of tipped employees underscore the importance of carefully evaluating your payroll practices. The DOL, courts, and plaintiffs' attorneys are scrutinizing employers' use of tip credit, distribution of service charges, deductions from tipped employee wages, and tip pooling practices.

Despite the increased focus on the compensation of tipped employees, the law in the area is unsettled. As a result, hospitality employers are wrestling with many questions about the best practices for paying tipped employees. Of note, the court found that, based on Applebee's admissions, it had the ability to track and pay employees for non-tipped duties. Some businesses have already moved to this type of "split pay" process, paying tip credit only for tip-related duties and minimum wage for all other duties. While not practical for all types of tipped employees, this is likely the safest option until this issue is resolved.

Notwithstanding the outcome of the Applebee's decision, employers are advised to carefully review their policies and practices for compensating tipped employees to ensure compliance with the law. To best insulate your company from costly investigations and litigation, hospitality employers should explicitly and regularly communicate to employees and managers the importance of accurately recording hours worked and tips received, train managers and supervisors on the laws regarding compensation of tipped employees, and regularly audit time records. The failure to do so, could subject employers to costly litigation.

For more information contact either of the authors: htighe@laborlawyers.com, kluchka@laborlawyers.com, or call 803.255.0000.

OSHA Compliance For Restaurants

By Howard Mavity (Atlanta)

Restaurants and their trade associations are justifiably proud of their food safety efforts as shown by the July 27, 2011 announcement by the National Restaurant Association celebrating over one million classes of restaurant industry training. But inspections by the Occupational Safety and Health Administration (OSHA) continue to turn up significant shortcomings in restaurant OSHA compliance – and these issues are not limited to the large institutional setting.

These problems may not result in employee injuries but can greatly harm a restaurant when it experiences a union drive, or complaints by a disgruntled employee who uses OSHA to harass the employer due to unrelated grievances.

Restaurants located in hotels, stadiums, airports and certain states are especially vulnerable to employee or union focus, as illustrated by UNITE HERE's highly publicized use of OSHA ergonomic complaints against Hyatt hotels. Likewise, OSHA just kicked off a Regional Emphasis inspection program including New York, New Jersey, and the Virgin Islands. An even more visible alert was the November 1 OSHA announcement of an "Alliance" with the UNITE HERE supported *Restaurant Opportunities Center United (ROC-United*), a group focused on restaurant workers' rights.

Even the resurrected Wobblies (the Industrial Workers of the World – a union usually associated with a bygone era) have moved from their union efforts against Starbucks to a focus on Jimmy John's. There can be little doubt that one way or another, restaurants, from chains to stand-alones, will soon see increased OSHA scrutiny.

Take It Seriously

In an era where whistleblower and retaliation claims outpace every other type of employment claim, one can never tell when a disgruntled employee may file a frivolous complaint. Accordingly, restaurants should take certain basic steps to review and eliminate common, often overlooked OSHA violations. As a bonus, improved OSHA compliance will also reduce hazards and provide a non-union employer an opportunity to demonstrate interest to its employees, as well as better engage them in the company's success. Such efforts will improve morale, productivity and customer service, and likely reduce employee grievances and legal claims.

Here are some areas of concern, and some practical steps, applicable to any restaurant setting:

Location

Evaluate exposure presented by your unique "environment." Are your restaurants freestanding or located in hotels, stadiums or airports? Freestanding units experience fewer OSHA inspections and are less likely to experience citations for exits, egress, signage, emergency-action plans, fire extinguishers, and blocked exits that they may have difficulty controlling, than are restaurants in an airport, mall, or other large space.

Chains have more exposure than single restaurants, and of course, size matters. More employees translate to more compliance issues, more opportunities to miss something, and more chance of disaffected employees.

Hours

An owner with multiple locations or 24-hour operations is more likely to experience compliance concerns because of more challenging span-of-control issues, inconsistent application of policies, reduced or less-trained supervision, and difficulty in ensuring that smaller units comply with corporate-driven safety and health efforts.

From a monetary exposure standpoint, employers with multiple locations face the risk that citations against a unit in one state will then result in more costly "repeat" or "willful" OSHA citations at other states' locations for a full five years after the first citation. The Administration has extended the repeat period from three to five years, with the result that after visits to different units, an employer may be looking at $70,000 for each extinguisher removed from the wall or a missing Material Safety Data Sheet (MSDS) for a chemical. Retail employers have already learned this painful lesson.

Turnover

The more turnover, the more exposure, because some employees may fall through introductory or annual safety training. Even if only one of 60 employees isn't trained to evacuate the facility or use fire extinguishers an employer can be cited; OSHA does not give "partial credit" or grade on a curve.

Allocation Of Resources

Focus on the 45 standards OSHA most commonly cites, including:

- Hazard Communication (site-specific plan, training, MSDSs, etc.)
- inadequate Job Hazard Analysis (JHA) and proper Personnel Protective Equipment (PPE)
- common electrical items, including unlabelled switches, frayed or misused extension cords, missing GFIs, and holes in electrical fixtures;
- failure to keep floors and work areas clean, orderly and safe, including slip hazards;
- missing or inadequate machine guards;
- maintenance of unblocked exit routes, fire extinguishers and electric panels, as well as adequate signage; and
- inadequate Emergency Action Plans.

Specificity

OSHA increasingly cites employers for lack of documentation of the "job" or "site-specific" aspects of safety training when all that an employer can provide is proof of a generic Hazard Communication plan or a safety DVD. Restaurants, like retailers, do not consider their workplaces to present many safety-training requirements or program needs, but the six-figure penalties recently assessed against pharmacies and strip mall stores suggest that omissions at those sites can still be costly.

Checklists

Utilize daily or weekly "checklists" of common safety compliance items, such as:

- are all exits, fire extinguishers and electric cabinets unblocked and clearly visible;
- are dishwashing and other chemicals properly stored;
- are employees using proper PPE and gloves when working with chemicals, such as cleaners and detergents;
- are floors maintained clear and dry, and nonslip footwear or mats used where needed;
- are employees "locking out" equipment when cleaning or doing maintenance; and
- is ventilation adequate and are work practices followed to avoid inadvertent mixing of common chemicals, such as the bathroom cleaning incident which resulted in a death in a Georgia restaurant earlier this year.

Continued on page 4

Lawsuit Serves Up Lessons For Restaurateurs

Employee Defection And Trade Secrets At Issue

By Brent Cossrow and Risa Boerner (Philadelphia)

A decision issued this summer by a federal district court in New York provides important lessons for professionals in the food services and restaurant industry regarding employee defection and trade secrets issues.

The litigation arose out of a dispute between BLT Restaurant Group and its accomplished executive chef Laurent Tourondel. BLT was formed in 2004 and operated 18 restaurants across the United States and internationally. BLT hired Tourondel as its Executive Chef and incorporated Tourondel's name and initials into the branding of the BLT restaurants, hence the acronym: Bistro Lourent Tourondel. One of the restaurants in the BLT family was BLT Burger.

On February 28, 2010, Tourondel left BLT. Shortly thereafter, he opened a new restaurant named "LT Burger." BLT sued Tourondel, a colleague of his who left with him, and LT Burger, and alleged that the LT Burger menu copied the BLT menu "almost exactly" and was based on BLT's confidential and proprietary information. BLT also claimed that LT Burger and Tourondel used the same proprietary recipes at LT Burger as were used at BLT Burger and that LT Burger misappropriated elements of BLT's marketing strategy by promoting Tourondel through similar media as were used by BLT.

In addition to violating Tourondel's contractual confidentiality and non-disclosure obligations, Tourondel breached his duty of loyalty to BLT and engaged in unfair competition, according to the lawsuit. LT Burger and Tourondel asked the court to dismiss the case. Their request was granted in part and denied in part, and the court's opinion is instructive for aspiring restaurateurs.

Analyzing The Ruling

The court turned first to the unfair competition claims, which had been filed under both federal and state law. As to the federal law, BLT claimed that the contents of the BLT Burger menu were entitled to legal protection as an identifying mark, and that "[t]he dining experience at BLT Burger is built around a unique menu." Tourondel argued that BLT's menu was not entitled to such protection because BLT's menu "played a functional role in the BLT dining experience and lack[ed] distinctiveness."

The court rejected these arguments, holding that this was a factual issue that could not appropriately be decided at the outset of the case on a motion to dismiss. Most interesting for industry professionals, the court also observed that Tourondel "failed to articulate a controlling or persuasive legal basis for a *per se* finding that the contents of the BLT Burger Menu cannot as a matter of law satisfy the requirements for trademark protection." Stated more simply, the court found that the menu could potentially be entitled to trademark protection. Citing these reasons, the court denied Tourondel's motion in part and allowed the federal unfair competition claims to proceed.

The court reached the opposite conclusion regarding the state law portion of the unfair competition claims, which were evaluated under a different standard. The New York state law unfair competition claims prohibit deceptive acts or practices by competitors. Here, BLT Burger alleged that LT Burger's use of the its menu and promotional models was deceptive. The court noted that in order for the state law unfair competition claims to survive Tourondel's motion, BLT Burger had to allege "a specific and substantial injury to the public interest over and above ordinary trademark infringement or dilution."

But the only injury identified by BLT Burger in its Complaint was consumer confusion over the menus, which the court held was insufficient as a matter of law, reasoning that even if customers were confused about LT's relationship to BLT, that would not necessarily injure those consumers, and would not constitute harm to the public at large. The court reached the same conclusion regarding LT Burger's use of promotional models, which related solely to alleged consumer confusion and an alleged injury suffered by BLT Burger, not the public. For these reasons, the court granted Tourondel's motion and dismissed the state law unfair competition claims.

The court also dismissed BLT Burger's claims for unjust enrichment. Seeking restitution or the return of money or property unjustly or improperly conferred on Tourondel, BLT Burger alleged that through unfair competition, the deceptive use of BLT Burger's menu and promotional model and breach of contract, money was unjustly conferred upon Tourondel.

In dismissing these claims, the court cited the rule that the existence of a valid and enforceable agreement ordinarily precludes recovery under legal theories like unjust enrichment for events arising out of the same subject matter covered in the agreement between the parties. Here the agreement between BLT Burger and Tourondel explicitly addressed all of the same facts and events that formed the basis of BLT Burger's unjust enrichment claim, so those claims were dismissed.

BLT Burger also alleged that Tourondel breached his contract with BLT Burger by using and disclosing BLT Burger's confidential and proprietary information in launching LT Burger. According to BLT Burger, this information consisted of BLT Burger's proprietary business models, financial and contractual information, "know-how," the development of the BLT Burger menu, the use of BLT Burger's proprietary recipes, and the promotion of Tourondel and LT Burger through a magazine used by BLT Burger to promote itself.

Tourondel argued that these claims should be dismissed because all of the information – except for the recipes – cannot be a trade secret as a matter of law. Notably, Tourondel conceded that the proprietary recipes could serve as the basis of a breach of contract claim. Focusing on this concession by Tourondel, the Court concluded that Tourondel was using the motion as a method to limit the scope of BLT's breach-of-contract claim, which was improper at this stage of the litigation. For this reason, the court denied Tourondel's motion to dismiss the breach-of-contract claims.

Similarly, the court allowed BLT Burger's breach-of-fiduciary-duty claims to proceed. BLT Burger alleged that a fiduciary relationship existed between itself and Tourondel as a result of certain contractual provisions that required Tourondel to provide consulting services to BLT Burger even after Tourondel left that restaurant. The court held that these allegations were sufficient to go forward, and again noted that Tourondel did not "articulate[e] any *per se* rules that would preclude Plaintiff from stating a claim."

Some Lessons To Be Learned

The Tourondel case is now in its discovery phase, and it will be interesting to see the outcome of BLT Burger's breach of fiduciary duty,

Continued on page 4

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Lawsuit Serves Up Lessons For Restaurateurs

Continued from page 3

breach of contract, and federal unfair competition claims. But there are some important lessons for restaurateurs and those investing in or launching restaurants, even at this early stage of litigation:

1. Make sure that agreements address confidentiality and non-disclosure obligations of key talent in the kitchen. These individuals can constitute a competitive threat if they leave, which makes it important that they agree at the outset not to disclose the restaurant's confidential and proprietary information. Such agreements can also help to support claims for special or emergency injunctive relief, such as a temporary restraining order, in the event a case requires some speedier action by a court.

2. Use employee policies that also define confidential and proprietary information and the ethical and permissible uses of such information. While the court in *Tourondel* did not discuss the existence of an employee manual, it can be an important tool to establish an employee's knowledge and understanding of what types of information are confidential and proprietary. This, in turn, can support claims for breach of contract and fiduciary duty.

3. Ensure the proper protection of confidential information by limiting access to that information and securing it on the premises. To the extent your restaurant has confidential or proprietary recipes or unique business methods and strategies, be sure to disclose them only on a "need to know" basis, and implement and enforce policies that strictly prohibit employees from copying or distributing the information or physically or electronically removing it from the restaurant for any reason.

For more information contact the authors: rboerner@laborlawyers.com, bcossrow@laborlawyers.com, or call 610.230.2150.

OSHA Compliance For Restaurants

Continued from page 2

Environment

Review the "pace" of work, turnover, language and literacy, and actual history to make safety programs genuinely applicable and effective. Teach employers to "recognize hazards," and if possible, use the not-so-common "common sense."

Ergonomics

Especially if the restaurant is located in a hotel or institutional setting, consider ergonomic issues, including evaluating storerooms, coolers, and freezers for materials handling, shelving, and other issues.

Take the above steps and you may also lessen the number of burns, slips, trips and eye injuries that even the best run restaurants still encounter. None of these steps are dramatic, but based on inspection data, many employers miss them.

For more information contact the author at hmavity@laborlawyers.com or 404.231.1400.

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