Wage Theft by Service Charge: Circuit Decisions Go Against the Purpose of the Fair Labor Standards Act and Approach Judicially Sanctioned Fraud

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ABSTRACT

Rising costs and inflation rates have created difficult times for both service industry employers and their employees. Business owners often implement service charges to offset their costs. But problems arise when employers try to siphon off service charges, effectively reducing total wages paid to their employees. Attempting to address this problematic ambiguity, courts have determined that service charges are not tips if the amount is fixed, non-discretionary, and included in the employer's gross receipts. Whether service charges are discretionary, however, is difficult to determine because the charges are ambiguously worded, and employers often remove the charges at a customer's request. The circuit courts have consistently upheld that service charges are not tips under the "discretionary" rule, but district court decisions are more varied in their interpretations.

A consistent treatment of service charges is necessary because service charges implemented by employers who pay their employees minimum wage—currently $2.13 per hour for tipped employees and a tip credit that must be at least $5.12 an hour—contravene the Fair Labor Standards Act's (FLSA)'s purpose of ensuring employees a living wage. This Comment focuses on actions the courts or legislature can take to address this problem. First, the courts should adopt a totality of circumstances test to determine whether a service charge is discretionary. Second, the courts or legislature should require that service charges unambiguously disclose whether the charges are tips. Third, they should adopt a rebuttable presumption rule, as currently applied in New York. These protections would strengthen the FLSA and bring its effect closer

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to Congress' original intent. Most importantly, these actions would provide relief to the nation's most vulnerable workers.

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I. INTRODUCTION

An employer owned an upscale sushi restaurant in North Carolina between 2014 and 2017.[1] His many employees earned an hourly wage between $2.13 to $2.50 per hour, a flat service charge, and a variable extra gratuity chosen by the customers.[2] The employer implemented a tip pool policy shortly after opening his restaurant.[3] Under this policy, he pooled and distributed both the automatic gratuity and the voluntary gratuity on the additional tip line of the customers' bills instead of giving the tip to the employees directly.[4] The restaurant's policy change substantially reduced the take-home wages for the employees.[5] The employees alleged that the service charges were tips and filed suit against the employer for unpaid wages.[6]

The plaintiffs argued that the tips were discretionary for many reasons.[7] First, the plain language on their receipts made the service charge seem like a tip.[8] A reasonable customer may have thought that the word "additional" meant that the charge labeled "automatic gratuity" was a tip.[9] Second, a reasonable customer may have thought that a 20% flat-rate charge was a tip because 20% is a typical gratuity, and they did not think that any other gratuity was expected.[10] Third, a reasonable customer may also have relied on the established custom of restaurants automatically including a fixed gratuity for large groups.[11] Finally, a reasonable customer may have been confused, even if they asked a server for clarification.[12] The servers gave inconsistent responses when they testified about whether the service charge was a tip.[13]

A service charge is simply a direct fee that tipped professions charge to balance their ledgers.[14] The service charge is often used to pay for business operations such as salaries for non-tipped staff, health insurance obligations for full-time staff, and minimum wage increases.[15] However,

1. *See* Tom v. Hospitality Ventures LLC, 355 F. Supp. 3d 329, 336 (E.D.N.C. 2018).
2. *See id.* $2.13–$2.50 is the minimum wage without the tip credit, the automatic gratuity is a service charge, and the variable extra gratuity is anything else given to the server by the customer on the "extra tip" line on a customer's bill. *See id.*
3. See *id.* This policy was referred to as the "AN PM Tip Pool." *Id.*
4. *See id.* at 337–40.
5. *See id.*
6. *See id.*
7. See *id.* at 344–45.
8. *See id.* at 337–40.
9. *See id.*
10. *See id.*
11. *See Tom*, 355 F. Supp. 3d at 337–40.
12. *See id.*
13. *See id.*
14. *See Do Service Charges in Restaurants Make Sense?*, DAVID SCOTT PETERS, https://perma.cc/2UZD-RCG5 (last visited Sept. 7, 2023).
15. *See id.*

service charges can be used for anything if they are included in the business's gross receipts.[16] Service charges are usually implemented because restaurants are reluctant to increase menu costs or they want to signal to their customers that the price increase is coming from a source outside the business owner's control.[17] Only the employer knows whether the service charges are being used to pay business costs or to pad profits because service charges do not have any special reporting requirements other than their inclusion in gross receipts.[18]

Although servers rely on customers' tips to make a living wage, they are caught between the employer's directives and customers' expectations.[19] Some employees in the case above believed the charge was removable at their manager's discretion, but many of them did not believe the service charges could be removed at all.[20] Generally, courts have greatly deferred to employers as to whether service charges are considered tips.[21]

This Comment seeks to describe the existing service-charge scheme and provide three resolutions that encourage future regulation. First, this Comment explains the current state and history of the minimum wage under the Fair Labor Standards Act (FLSA), details the regulations that currently govern service charges, and provides insight into customers' tipping practices.[22] Then, this Comment analyzes patterns in both the handful of circuit opinions and the larger body of district court opinions addressing service charges.[23] Finally, this Comment seeks to improve the use of service charges for employees and customers by offering several recommendations based on policy considerations and statutory, regulatory, and judicially created law.[24]

II. BACKGROUND

The law does not overlook service charges—in fact, multiple authorities inform how employers should treat them: (1) the FLSA's current language, underlying purposes, and legislative history; (2) the FLSA's service charge definition listed in the Code of Federal Regulations (CFR); and (3) relevant service charge caselaw.[25] Beyond the law,

16. *See id.*
17. *See id.*
18. *See id.*
19. *See infra* Section II.D.
20. Tom v. Hospitality Ventures LLC, 355 F. Supp. 3d 329, 334–45 (E.D.N.C. 2018).
21. *See infra* Section II.C.
22. *See infra* Section II.A.
23. *See infra* Sections II.B–D.
24. *See infra* Sections III.D.1–3.
25. *See infra* Sections II.A–C.

customers' tipping expectations, knowledge, and/or opinions about service charges affect a service charge's impact.[26]

A. The Fair Labor Standards Act

The FLSA, introduced during the Great Depression, attempted to provide relief to the lowest-paid Americans during desperate economic conditions.[27] In a national address, President Franklin D. Roosevelt stated that the FLSA was a "call on the nation's conscience" to ensure that every worker had a basic level of income.[28] Nearly a century later, the minimum wage, as applied through the FLSA, has developed into a complicated regulatory system that differentiates between tipped and non-tipped workers.[29]

1. Current Minimum Wage Law Under the FLSA

The FLSA tolerates a smaller minimum wage obligation for employers of tipped employees relative to non-tipped employees. For non-tipped employees, the current federal minimum wage is $7.25, which has not changed since 2007.[30] The minimum wage for tipped positions is more complicated: while tipped employees' base wage is $2.13, the remainder of their minimum wage obligation may be claimed through a tip credit, allowing the employer to pay less and make up the difference through customer-provided tips.[31] However, the actual tips earned by the tipped employee per hour must total at least $5.12 for the employer to claim the tip credit.[32] The total pay per hour for a tipped employee cannot be less than the federal minimum wage, and the employer must pay the employee the remainder if tips do not make up the $5.12 difference.[33] Any tips beyond that difference are the employee's property, unless there is a valid tip-pooling arrangement.[34] Additionally, the Department of Labor ("DOL") regulates tip-pooling and overtime calculations to further protect tipped workers.[35]

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26. *See infra* Section II.D.
27. *See* H.R. REP. NO. 93-913, at 2817 (1974).
28. *See id.* at 2814.
29. *See* 29 U.S.C. § 206(a).
30. *See id.*
31. *See* James Lockhart, Annotation, *Tips as Wages for Purposes of Federal Fair Labor Standards Act*, 46 A.L.R. Fed. 2d 23 § 2 (2023).
32. *See id.*
33. *See id.*
34. *See id.* Tip-pooling is a common restaurant practice under which all tips are collected and distributed according to an established policy. *See id*. § 41. The FLSA and associated regulations do not prohibit this practice for determining minimum wage obligations if only eligible employees receive wages from the tip pool. *See id.*
35. *See id.* Overtime pay is to be paid at one and a half times regular pay. *See id.* § 2.

Tipping is customary and expected in many industries.[36] Employers in these industries do not want to pay the same minimum wage for tipped employees as non-tipped employees because the former make extra money in tips.[37] The employers argue that the source of the income should not matter if the employees are taking home any amount higher than the required minimum wage because that amount meets the employers' FLSA obligations.[38] However, employees do not want their take-home pay leveled by laws that reduce their employers' obligations to them.[39] Also, the legislature's codification of tipping policies forces employees to rely on customers' charity instead of their employers' responsible management.[40] Although the use of a service charge to offset business expenses does not benefit both employees and employers equally, the compromise protects both the employer and the employee because the employee earns at least minimum wage and the employer's costs are substantially reduced if customers fulfill their customary duty to tip.[41]

2. History of the Minimum Wage Under the FLSA

The FLSA's signature provision was the establishment of a federal minimum wage.[42] Congress passed the FLSA under its Commerce Clause authority to ensure that every person who put in a day's work was able to afford a decent standard of living.[43] Subsequent amendments in 1949, 1955, 1961, and 1966 increased both the amount and the scope of the federal minimum wage.[44] Every time Congress amended the FLSA's minimum wage provision, opponents claimed that the amendment would increase inflation and decrease employment opportunities.[45]

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36. *See id.*
37. *See id.*
38. *See* Lockhart, *supra* note 31, § 2.
39. *See id.*
40. *See id.*
41. *See id.*
42. *See* H.R. REP. NO. 93-913, at 2811 (1974).
43. *See id.* at 2818.
44. *See id.* Although the FLSA considers the federal minimum wage by its dollar amount, "the coverage of the minimum wage is no less important than its amount." *See id.* (quoting President Dwight Eisenhower in 1955). Minimum wage opponents have argued that minimum wage laws' protections should be limited to larger employers because small businesses are less able to bear the cost of an increased minimum wage and have less power to exert on their workers. *See generally* 135 CONG. REC. H7871 (daily ed. Nov. 1, 1989) (statement of Rep. Rahall) (explaining that the tip credit was included as a compromise and the "bill is indeed a minimum wage bill—and it is the least we can do in every sense of the word"); H.R. REP. NO. 95-521, at 3253 (1977) (rejecting the idea of indexing as an "abdicat[ion] of its responsibility to statutorily determine and set the minimum wage").
45. See H.R. REP. NO. 93-913, at 2828. In addition to opposition within Congress, employers also challenged these measures in the courts: *Maryland v. Wirtz* was the first constitutional challenge to an expansion of the scope of the minimum wage. *See* Maryland v. Wirtz, 392 U.S. 183, 188 (1968). The Supreme Court's decision in *Wirtz* upheld the

The federal minimum wage's expansion peaked with a 1974 amendment that increased the wage's reach.[46] A subsequent 1977 amendment generally continued this expansive trend by reducing the tip credit, raising wages, and increasing the scope of the Act.[47] Opponents of the minimum wage increases argued that such increases would also increase inflation, but the legislature reasoned that inflation is not caused by minimum wage increases: unemployment had decreased, there was neither an upstream nor downstream "ripple effect," and the Chamber of Commerce's state-by-state analysis of the supposed inflationary effects was flawed because of its limited scope.[48] However, the amendment's opponents successfully blocked an attempt to index wages to keep up with inflation.[49] The 1977 amendment's opposition argued that the tip credit should be preserved because FLSA's purposes are best served if the employer is forced to pay at least minimum wage.[50] The minimum wage opponents warned that a decrease in the tip credit and an increase in the minimum wage might cause tipped professions to implement a service charge to cover the difference.[51] Ultimately, the opposition lost, and Congress reduced the tip credit from $1.15 to $1.00 over the course of three years.[52] The plan was to reduce the tip credit progressively in future amendments until it was eliminated, but these amendments never came.[53]

The purchasing power of the minimum wage contracted over the next 50 years as inflation rose, but the spending power of the dollar stayed the same.[54] The purchasing power of the minimum wage approached Great Depression-era levels by 2022 despite increases to $4.15 in 1989, $5.15 in

extension of the federal minimum wage to public employees. *See id*. The Court reversed course in *National League of Cities v. Usery* and held that there should be an exception to the reach of the FLSA for "traditionally public functions" such as determining wages for city workers. Nat'l League of Cities v. Usery, 426 U.S. 833, 840 (1976). However, the Court reversed course again in *Garcia v. San Antonio Metropolitan Transportation Authority* and overruled the "traditional public functions" exception. Garcia v. San Antonio Metro. Transp. Auth., 469 U.S. 528, 554 (1985).

46. *See* H.R. REP. NO. 93-913, at 2815. The 1974 amendment was stalled four times, which represented the greatest challenge to the minimum wage provision of the FLSA since its inception 35 years earlier. *Id.*

47. *See* H.R. REP. NO. 95-521, at 3214. (1977).

48. *See id.*

49. *See id*. at 3252. Indexing wages would have made increases to the minimum wage automatic and avoided delay caused by the "irregular and frequently chaotic legislative process." *See id.* at 3223.

50. *See id.* at 3231.

51. *See id.* at 3250. Employers did end up adopting service charges, but not because of minimum wage increases. *See supra* Part I.

52. *See id.* at 3203.

53. *See* Lockhart, *supra* note 31, § 2.

54. *See 1938 United States Minimum Wage in Today's Dollars*, DOLLARTIMES, https://perma.cc/649C-AAEZ (last visited Sept. 7, 2023).

1996, and $7.25 in 2007.[55] In 1989, proponents of the minimum wage increase argued that previous minimum wage increases had no inflationary effect, but the opponents nevertheless successfully reinstated the tip credit at $2.13, 50% of the minimum wage at the time.[56] The federal minimum wage obligation for employers that did not come from tips stalled at $2.13 for the next 33 years.[57]

Each increase in the federal minimum wage for tipped employees since 1989 has increased the tip credit rather than increased the minimum wage value itself.[58] The 1996 amendment raised the minimum wage, and its proponents overcame an attempt to limit its scope.[59] The minimum wage last increased 15 years ago, despite substantial opposition in an otherwise bipartisan-supported spending bill.[60] Many legislators attempted to increase the minimum wage in the past 15 years, but to no avail.[61]

3. Classification of the Service Charge

Although the service charge, as distinguished from a tip, is enjoying a renaissance, the service charge is nearly 55 years old.[62] The DOL saw the need for regulations to help implement the FLSA in a consistent way in response to the Fair Labor Standards Amendments of 1966, which supplemented section 3(m) and provided a new section 3(t).[63] Therefore, the DOL promulgated the following federal regulation that established how to classify service charges:

> A compulsory charge for service, such as 15[%] of the amount of the bill, imposed on a customer by an employer's establishment, is not a

55. *See id.*

56. *Compare* 135 CONG. REC. H7859 (daily ed. Nov. 1, 1989) (statement of Rep. Gaydos) (arguing that inflation is unrelated to any past minimum wage increases and that the increase was needed just to keep pace with inflation), *with* 135 CONG. REC. H7868 (daily ed. Nov. 1, 1989) (statement of Rep. Dreier) (arguing that minimum wage should be tailored to each state's needs and a minimum wage increase will eliminate many jobs).

57. *See* 135 CONG. REC. H7864 (daily ed. Nov. 1, 1989) (statement of Rep. Kleczka).

58. *See id.*

59. *See* S. REP. NO. 104–281, at 6 (1996). Opponents of the minimum wage increase wanted to compromise by raising the wage in a bill that would also include a list of small business exemptions that would substantially limit the minimum wage's impact on small businesses. *See id.*

60. *See* U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, Pub. L. No. 110–28, § 8102, 121 Stat. 112, 188 (2007).

61. *See id.*

62. *See* 29 C.F.R. § 531.55 (2022); 29 U.S.C. § 203. The two recent Eleventh Circuit decisions relied on the regulation. *See* Compere v. Nusret Miami, LLC, 28 F.4th 1180, 1187 (11th Cir. 2022); Nelson v. MLB Hotel Manager, LLC, No. 21-10181, 2022 WL 2733720, at *2 (11th Cir. July 13, 2022).

63. *See* Wage Payments Under the Fair Labor Standards Act of 1938, 32 Fed. Reg. 13575, 13580 (proposed Sept. 28, 1967) (to be codified at 29 C.F.R. pt. 531.55); *see also* Crediting Tips as Wages: Notice of Proposed Rule Making, 32 Fed. Reg. 222 (published Jan. 10, 1967).

> tip and, even if distributed by the employer to its employees, cannot be counted as a tip received in applying the provisions of sections 3(m)(2)(A) and 3(t). Similarly, [when] negotiations between a hotel and a customer for banquet facilities include amounts for distribution to employees of the hotel, the amounts so distributed are not counted as tips received.[64]

The language of the regulation is virtually identical to the original rule proposed in 1967.[65] The DOL's only change was to account for tip-pooling practices; however, the DOL's interpretation of "service charge" remained the same.[66] The original proposed rule provides further insight into the drafters' intent.[67] Originally, if the employment agreement allowed, then the employer could count tips as additional income regardless of the customer's intent.[68] Subsection (b) of the current service charge classification rule is also hinted at by the original proposed rule: the employer must list the service charge as either taxable income or a tip.[69] If the employer uses any of the service charge income to pay salary to tipped employees, then that part of the service charge may count toward the employer's FLSA tip credit obligations.[70] The CFR clearly distinguishes between service charges and tips and establishes that service charges are meant to be a separate tool from tips.[71]

The context of the entire chapter of the FLSA's minimum wage regulations, and the broader purposes of labor regulations generally, however, show that the impact of the rules is not as clear-cut as it appears.[72] The same subchapter—regarding income that may be included as wages—notes that the courts are ultimately responsible for determining whether a service charge is a tip.[73] There is value in having a persuasive, interpretive guide, but this guide cannot replace the courts' contrary interpretations of the law.[74] However, the presumption that a service charge is not a tip should "only to be set aside by the court when justified by very good reasons."[75]

Commentators have called the classification of service charges a "legal gray area" because service charges resemble—but are distinct

64. 29 C.F.R. § 531.55(a).
65. *See id.*
66. Wage Payments Under the Fair Labor Standards Act of 1938, 32 Fed. Reg. at 13580.
67. *See id.*
68. *See id.*
69. *See id.*
70. *See id.*
71. *See id.*
72. *See* 29 C.F.R. § 531.25.
73. *See id.*
74. *See id.*
75. *See id.* (citing Skidmore v. Swift, 323 U.S. 134, 140 (1944)).

from—tips.[76] Lending support for their similarity, one frequently mentioned purpose of a service charge is to transfer responsibility of increasing workers' salaries from business owners to patrons, just like tips.[77] Their ambiguity leaves servers with the flummoxing task of explaining to patrons how the service charge—which is ostensibly intended to pay service costs, but counts toward the employees' wages, is thus not a tip.[78] Customers, then, are confused about whether they should continue to tip, as is customary, or rely on the service charge.[79]

4. Customers' Tipping Preferences

Sociologists have documented customers' tipping motivations, customs, and preferences.[80] One study found that customers are more likely to tip for positive than negative reasons.[81] The study notes that customers' tipping behavior cannot be explained through the actions of an economic self-maximizer.[82] Although the study does not question whether service charges are tips, it explains how customers' tipping behaviors and motivations are important when employers implement service charges.[83] The study concludes that service charges would not harm customers if they tip solely to avoid negative consequences.[84] The customer is unlikely to be ostracized for their non-tipping behavior, even if a service charge is not a tip.[85] However, if customers tip for positive reasons, a service charge "eliminates this source of positive outcomes, possibly reducing social

76. *See* Autumn Swiers, *Why More and More Restaurants May Be Adding Service Fees to Your Bill*, TASTINGTABLE (June 3, 2022, 2:26 PM), https://perma.cc/V737-4QLD.

77. *See id.*

78. *See id.*

79. *See id.*

80. *See, e.g.*, Michael Lynn, *Service Gratuities and Tipping: A Motivational Framework*, 46 J. ECON. PSYCH. 74, 74–83 (2015) (discussing the different motivations which drive customers to tip and the reasons people tip or do not tip workers in different professions); Ofer H. Azar, *Tipping Motivations and Behavior in the U.S. and Israel*, 40 J. APPLIED SOC. PSYCH. 421, 421–57 (2010) (ranking and explaining reasons that motivate tipping behavior).

81. *See* Azar, *supra* note 80, at 426. The study defined the positive reasons that induced the surveyed customers to tip and noted that customers with positive reasons tipped more; these reasons include social normalization of tipping (84.7% of sampled customers), gratitude (67.8%), and servers' reliance on tips (66.9%). *Id.* at 423–25. In contrast, the negative reasons identified in the survey resulted in smaller tips; these reasons include guilt for not tipping (60.2%), embarrassment for not tipping (44.1%), the risk of adverse effect on future service (13.6%), and the risk of being yelled at by the server or another person at the business (4.2%). *Id.*

82. *See id.* at 425. An economic self-maximizer considers the financial return of any given action to the exclusion of any other non-financial consideration. *See id.*

83. *See id.* at 426.

84. *See id.*

85. *See id.* This scenario would be unequivocally true if the service charge is a tip. *See id.*

welfare."[86] A mandatory service charge does not give customers the ability to tip for the usual reasons: showing gratitude and altruism or actively engaging in a settled custom.[87] The study also finds that people prefer tipping rather than paying service charges.[88] The clear majority (59.8%) prefer tipping to service charges, while the remainder are split among indifferent patrons (21.4%) and patrons who prefer service charges (18.8%).[89]

Finally, the study mentions that service charges widely replace tips in Europe, and that service charges commonly replace tips for large parties in the United States.[90] Another study noted how this tipping expectation has evolved because upper-class customers normalized service charges into ubiquity.[91] Because tipping comes from these roots, tipped occupations are more likely to have prolonged proximity between the employee and the customer.[92] Relatedly, the customer will have a higher income relative to the employee universally.[93]

If courts or the legislature provided a remedy that brought tipped workers closer to a living wage, many outcomes would improve for tipped workers.[94] Employee turnover would decrease.[95] Employees would be less likely to depend on government assistance such as the Supplementary Nutrition Assistance Program ("SNAP") or the Temporary Assistance for Needy Families ("TANF").[96] Employees would also not suffer from a lack of a living wage that leads to "insecurity, stress, lower self-esteem, alcohol

86. *See id.*

87. *See id.* The proposition that service charges can negatively impact service is further supported by the related concept of tip-pooling. *See id.* at 438 (concluding that employees who are relegated to a fixed amount have less incentive to provide excellent service because their tip percentage will only increase marginally based on their service quality).

88. *See id.* at 444–50.

89. *See id.* The surveyors asked: "Do you prefer that the restaurant will add a service charge of 15% to the bill instead of tipping?" *Id.* at 445.

90. *See id.* at 445.

91. *See* Lynn, *supra* note 80, at 78. A custom that used to be an incidental award to favored members of the servant class in England has become an expectation deeply tied to the wage schemes of all tipped employees. *See id.* This situation occurred when the higher status people tipped as a way of reinforcing their class status among their peers and rewarding incidents of good behavior from their servants. *See id.* Upwardly mobile middle-class people—and those who wanted to be middle class—emulated this behavior until it became more common. *See id.* at 79. The feedback loop created by this behavior continued until tipping became an expectation. *See id.* Once it became an expectation, federal and state legislatures codified it into our minimum wage laws. *See id.*

92. *See id.*

93. *See id.* at 83.

94. *See* Lakeisha A. Wade, Exploring Strategies Small Business Owners Use to Improve Employee Retention (Dec. 18, 2020) (DBA dissertation, Colorado Technical University) (ProQuest).

95. *See id.* at 20.

96. *See id.*

abuse, depression, work absenteeism, and other health [problems.]"[97] When tipped service workers are paid more, they may recirculate those wages back into the economy by spending more on both necessities and discretionary purchases.[98]

B. Circuit Court Decisions

Every circuit court that has addressed the issue has held that a service charge is not a tip for the purposes of the FLSA's minimum wage provisions.[99] However, the district courts have created carveouts that complicate the circuit courts' consensus.[100]

1. The Seventh Circuit

The Seventh Circuit was the first to determine whether a service charge is a tip in the context of a luxury hotel collecting a service charge for banquet services.[101] The plaintiffs—servers working under a collective bargaining agreement—claimed that the hotel violated the DOL overtime regulations.[102] Among other things, the servers argued that the service charges on the bill were tips and could not be added toward their employer's FLSA obligation.[103] Judge Posner held that the service charges were commissions under the FLSA.[104] The court reasoned that the FLSA provisions were meant to protect the severely underpaid.[105] The hotel banquet laborers were making $14 to $18 per hour in 1986 dollars under union protection.[106] According to Posner, the FLSA was not meant to protect these laborers.[107]

The court further held that the service charge "was not a 'gratuity' because it was not discretionary."[108] They reasoned that the commissions the hotel banquet employees received were closer to salespeople's commissions and, therefore, were not severable as a gratuity.[109] Also, the

97. *See id.* at 21 (citing J.D. Wisman & A. Pacitti, *Ending the Unemployment Crisis with Guaranteed Employment and Retraining*, 48 J. ECON. ISSUES 679 (2014)).

98. *See id.* at 27.

99. *See* Mechmet v. Four Seasons Hotels, Ltd., 825 F.2d 1173, 1177 (7th Cir. 1987); Tom v. Hosp. Ventures LLC, 980 F.3d 1027, 1037 (4th Cir. 2020); Compere v. Nusret Miami, LLC, 28 F.4th 1180, 1189 (11th Cir. 2022); Nelson v. MLB Hotel Manager, LLC, No. 21-10181, 2022 WL 2733720, at *2 (11th Cir. July 13, 2022).

100. *See infra* Section II.C.1.

101. *See Mechmet*, 825 F.2d at 1173.

102. *See id.*

103. *See id.* at 1177.

104. *See id.*

105. *See id.*

106. *See id.*

107. *See id.*

108. *Id.*

109. *See id.* at 1176.

court considered the policy implications by stating that "a contrary interpretation might cause considerable turmoil in a major industry without benefiting anyone except lawyers."[110] Finally, the court noted that although minimum wage protections cannot be interpreted broadly themselves, "generalizations about interpretation . . . are a tie-breaker at best."[111] No other circuit court would hear a case concerning service charges for the next 30 years.[112]

2. The Fourth Circuit

The Fourth Circuit was the next to weigh in on the appropriate classification of a service charge.[113] The facts of the case, discussed in more detail in Part I of this Comment, center around a claim for unpaid wages originating, in part, from an ambiguous restaurant service charge.[114] The court focused on the history and purpose of the FLSA, and it observed that the FLSA does not contain a definition of "service charge."[115] The district court granted summary judgment in favor of the defendant-employer.[116] The court held that a service charge is a commission for purposes of determining whether an overtime violation occurred.[117] The circuit court adopted the district court's reasoning that a commission, which neither the FLSA nor the DOL's regulations define, is intended to be distinct from a gratuity.[118] Therefore, the service charges could not be counted as tips to support an overtime violation claim.[119]

The plaintiff-employees argued that genuine issues of material facts existed as to whether the service charge was mandatory.[120] They also argued that the gratuity was discretionary because customers successfully removed the service charge and the defendant did not charge every customer an automatic gratuity.[121] The court held that "the material issue [was] not whether customers always paid a 20% automatic gratuity[, but] *who* determined whether and how much to pay."[122] The court reasoned that because the customers did not have "unfettered discretion" to choose whether to pay the service charge, the choice was ultimately the

110. *See id.* at 1177.
111. *See Mechmet*, 825 F.2d at 1177.
112. *See id.*
113. *See* Tom v. Hosp. Ventures LLC, 980 F.3d 1027, 1036 (4th Cir. 2020). Most of the opinion focused on a related tip-pooling issue. *See id.* at 1040.
114. *See id.* at 1036; *supra* Part I.
115. *See Tom*, 980 F.3d at 1031–34.
116. *See id.* at 1035.
117. *See id.* at 1038.
118. *See id.* at 1036.
119. *See id.* at 1040.
120. *See id.* at 1037.
121. *See id.* at 1035.
122. *See id.* at 1038.

employer's.[123] However, the court qualified its opinion by stating that some service charges included on a restaurant bill could be classified as tips and pointed to several district court opinions in which there were genuine issues of material fact as to whether the service charges were tips.[124] The court reasoned that the dispositive factor was whether the employer or the customer ultimately had the discretion to waive the service charge.[125]

3. The Eleventh Circuit

Most recently, the Eleventh Circuit weighed in with two similar cases: *Compere v. Nusret Miami* and *Nelson v. MLB Hotel Manager*.[126] The former involved an upscale Miami steakhouse run by Nusret Gokce, an internet celebrity known as Salt Bae.[127] His employees argued that the steakhouse's 18% service charge was a tip and could not be used for FLSA purposes.[128] The service charge was referenced on the menu "[f]or [the customer's] convenience" and included language that said the charge would be "distributed to the entire team."[129] On the check, there was an additional line for gratuity and some of the staff said that the service charge was "non-negotiable."[130]

The court held that the service charge was not a tip under these circumstances.[131] Nothing in the record showed that the customer had the power to remove the charge.[132] Possibly because of Florida's state minimum wage raise, the employer changed its payment process by paying its employees completely out of the service charge and eliminated its hourly rate.[133] The employer pointed to the 207(i) provisions to argue that the steakhouse's new system was lawful because it received over half of its income from commissions (the service charges) and employees made over one and a half times the minimum wage.[134] The employees alleged

123. *See id.* at 1038.
124. *See id.*
125. *See Tom*, 980 F.3d at 1038. (reasoning that the motion to dismiss might have been denied if a business advertised a "suggested" service charge).
126. Compere v. Nusret Miami, LLC, 28 F.4th 1180, 1187 (11th Cir. 2022); Nelson v. MLB Hotel Manager, LLC, No. 21-10181, 2022 WL 2733720, at *2 (11th Cir. July 13, 2022).
127. *See* Olee Fowler, *Salt Bae's Nusr-Et Debuts in Brickell,* EATER MIAMI (Nov. 10, 2017, 9:55 AM), https://perma.cc/Z4J9-CEFR; *see also* Greg Morabito, *Is Salt Bae Actually Tip-Skimming Bae?*, EATER (Jan. 18, 2019 5:42 PM), https://perma.cc/NNE7-DMR8.
128. *See Compere*, 28 F.4th at 1181.
129. *Id.* at 1182.
130. *Id.*
131. *See id.*
132. *See id.*
133. *See id.*
134. *See id.* at 1183.

that the service charge was a tip.[135] In response to a motion for summary judgment, the employees alleged that there was a genuine issue of material fact as to whether the employer claimed service charges on its taxes and whether managers could remove service charges for dissatisfied customers.[136] The district court held that the employer correctly applied the overtime regulation and that the service charge was not a tip because customers did not have complete discretion to remove it.[137]

On appeal, the Eleventh Circuit upheld the district court's decision.[138] The court pointed to the definition of "tip" and "examples of amounts not received as tips" in the DOL regulations, noting that the difference between the example given by the regulation and the amount used by the employer was immaterial.[139] The court also reasoned that the employer's taxes were "irrelevant" for service charge purposes because the inquiry is whether the service charge is a tip.[140] If a service charge is not taxed properly, it does not thereby become a tip.[141] Finally, the court reasoned that the customer's ability to request removal of the service charge does not turn it into a tip because the ability to remove the service charge lies with the manager and not the customer.[142]

The Eleventh Circuit also decided *Compere's* companion case as a straightforward application of the presumption that a service charge should not be considered a tip.[143] The facts in *Nelson v. Hotel Manager, LLC,* are similar to the facts of *Compere* in that an upscale restaurant employee challenged a service charge that was colorable as a tip.[144] The only substantive difference was that the menu referred to the service charge as "non-discretionary" even though, as in *Compere*, the managers had discretion to remove it if a customer complained.[145]

The court upheld the district court's grant of summary judgment in favor of the employer because it read 29 C.F.R. § 531.55 as classifying non-discretionary service charges as separate from tips.[146] However, the court tacitly admitted that there is a colorable argument for the service

135. *See id.*
136. *See id.*
137. *See id.*
138. *See Compere*, 28 F.4th at 1183.
139. *See id.* at 1186. The court noted that the only difference between the defendant's applied service charge and the example in the regulation is the former is 18% and the latter is 15%. *See id.*; *see also* 29 C.F.R. § 531.55 (2022).
140. *Compere*, 28 F.4th at 1186.
141. *See id*. at 1188.
142. *See id.*
143. Nelson v. MLB Hotel Manager, LLC, No. 21-10181, 2022 WL 2733720, at *2 (11th Cir. July 13, 2022).
144. *See id.* at *5.
145. *See id.* at *6.
146. *See id.* at *8; 29 C.F.R. § 531.55.

charge being a tip by admonishing the employer's counsel for filing sanctions against the employee's counsel.[147] The court did not find the employee to be a vexatious litigants because their claim was not futile, and it ordered defendant's counsel to pay attorneys' fees.[148]

The history of the circuit courts' approach began with an atypical, non-restaurant application in the Seventh Circuit, followed by three decades of silence.[149] Afterwards, both the Fourth Circuit and the Eleventh Circuit weighed in within two years of each other.[150] These four decisions reflect a general deference to the CFR, and all four cases involve upscale employers as defendants.[151] Further, these cases hold that service charges are not tips. The modern cases also differ from *Mechmet* in that their holdings almost entirely rest on the employer's intent. However, the universe of possible service charge considerations is much larger than the body of circuit decisions indicates.

C. District Court Opinions

Although the circuit courts all held that a service charge is a tip unless the customer chooses whether to pay the service charge, district court decisions complicate, and ultimately weaken, the circuits' impact.[152] The district court trends may be lumped into three, often overlapping groups: (1) opinions that challenge the service charge as discretionary, (2) opinions that challenge the service charges for not being part of the business's gross receipts, and (3) opinions that challenge the service charge by applying substantive New York state law.[153]

1. Opinions that Challenge the Service Charge as Discretionary

Unlike the cases heard at the appellate level, district court plaintiffs seeking to categorize service charges as tips have had more success because there were sufficient indicia that the service charge was a discretionary gratuity.[154] One court from the Southern District of Florida

147. *See Nelson*, 2022 WL 2733720, at *8–11.

148. *See id.*

149. *See* Mechmet v. Four Seasons Hotels, Ltd., 825 F.2d 1173, 1177 (7th Cir. 1987).

150. *See* Tom v. Hosp. Ventures LLC, 980 F.3d 1027, 1037 (4th Cir. 2020); Compere v. Nusret Miami, LLC, 28 F.4th 1180, 1189 (11th Cir. 2022); *Nelson*, 2022 WL 2733720, at *3. While the other decisions predate the COVID-19 pandemic, both decisions before the Eleventh Circuit were likely brought due to the pandemic-created crisis in the service industry. While the circuit courts unanimously upheld service charges as not being tips, the Eleventh Circuit went a bit further, stating in dicta that gross receipts do not need to include service charges. *See Compere*, 28 F.4th at 1189; *Nelson*, 2022 WL 2733720, at *3.

151. *See Mechmet*, 825 F.2d at 1175; *Tom*, 980 F.3d at 1031; *Compere*, 28 F.4th at 1181; *Nelson*, 2022 WL 2733720, at *1.

152. *See infra* Sections II.C.1–3.

153. *See infra* Sections II.C.1–3.

154. *See* Lockhart, *supra* note 31, § 22.

found that service charges can be tips if the menu includes language such as "PALACE BAR ADDS, FOR YOUR CONVENIENCE, A SUGGESTED 20% SERVICE CHARGE TO ALL TABLE SERVICE BILLS. *PLEASE ASK YOUR SERVER IF YOU WOULD LIKE THIS REMOVED.*"[155] However, less-objective evidence can overcome the presumption against treating service charges as tips.[156] In the same case, the defendant's "corporate representative" testified that customers have the option to pay the suggested service charge.[157] Importantly, the court reasoned that the service charge was not mandatory simply because it was included on every bill, but the service charge would have been mandatory if the customer was required to pay it.[158] In a similar case, the court rejected the idea that service charges were not tips as a matter of law; the Southern District of Florida held that these "disputed interpretations of the mandatory nature of the service charge" have no compelling authority to settle them as a matter of law, especially if factfinding has not yet occurred.[159]

Courts interpret the mandatory requirement along a spectrum; one extreme requires that a service charge be completely mandatory for it to not be a tip, and the other extreme never treats a service charge as a tip if the employer ultimately chooses whether to enforce the service charge.[160] Florida is a great case study in this spectrum: several of the earlier district court opinions such as *Soliman v. SOBE Miami, LLC* and *Lalic v. CG RYC, LLC* pushed the state toward the "absolute compliance" end of the spectrum, while *Rosell v. VMSB* and the Eleventh Circuit opinions drifted toward the "not a tip even with management waiver" position.[161]

Rosell was more ambitious than the other district or appellate opinions because it attempted to justify its holding through both prior Southern District of Florida caselaw and appellate opinions from other

155. Soliman v. SOBE Miami, LLC, 312 F. Supp. 3d 1344, 1351 (S.D. Fla. 2018) (emphasis added).

156. *See* Lockhart, *supra* note 31, § 22.

157. *Soliman*, 312 F. Supp. 3d at 1351 (noting that employee gave deposition testimony that the service charge was "suggestive [sic]").

158. *See id.* at 1352.

159. Lalic v. CG RYC, LLC, No. 18-20118-CIV, 2018 WL 5098883, at *6 (S.D. Fla. Aug. 13, 2018); *see* Schultze v. 2K Clevelander LLC, No. 12-CV-22684, 2018 U.S. Dist. LEXIS 147352, at *10–14 (S.D. Fla. Aug. 28, 2018) ("[S]omething less than [the] absolute application of the service charge [has no basis in] law or evidence . . . .").

160. *Compare Schultze*, 2018 U.S. Dist. LEXIS 147352, at *10–14 (finding a genuine dispute of material fact as to whether the service charge was discretionary), *with* Rosell v. VMSB, No. 20-20857, 2021 U.S. Dist. LEXIS 116663, at *9–10 (S.D. Fla. June 22, 2021), *appeal docketed*, No. 22-11325 (11th Cir. Apr. 22, 2022) (finding that a service charge can never be discretionary if the employer intended for it to be mandatory).

161. *See* Lockhart, *supra* note 31, §§ 22–23.

districts.[162] The court reasoned that there was no evidence that customers could remove the service charges; instead, the decision to include the service charge was at the sole, "unfettered" discretion of the restaurant.[163] Additionally, the Eastern District of Louisiana held that if service charges and tips are mixed together and not severable, then the service charges cannot be used to offset minimum wage obligations.[164]

Not every court favors one extreme or the other.[165] The District of Alaska created a list of factors for determining whether a service charge is a tip:

> (a) [w]hether the payment was made by a customer who has received a personal service; (b) whether the payment was made voluntarily in an amount and to a person designated by the customer; (c) whether the tip is regarded as the employee's property; (d) the method of distributing the payment; (e) the customer's understanding of the payment; and (f) whether the employer included the payment in its gross receipts.[166]

Many district courts hold that a mandatory service charge can be reclassified as a tip if the individualized inquiry reveals the right set of facts.[167] For example, one court upheld a discovery request to establish the service charge amount and how it was calculated to determine whether the service charge could be considered a tip.[168]

2. Opinions that Challenge the Service Charge for not Being Part of a Business's Gross Receipts

Most of the service charge caselaw and all caselaw in this Section concerns the adult entertainment industry.[169] Most district courts find that service charges in this industry are not mandatory because they are not

162. *See Rosell*, 2021 U.S. Dist. LEXIS 116663, at *24–26 (reasoning that *Tom* sharpened the rule established in *Lalic*). The *Rosell* court reasoned that *Lalic* was not at odds with *Tom* because it "clarified that a service charge is a tip based on *who determines* the [existence of] a gratuity and the amount." *Id.* at *26 (emphasis added).

163. *Id.* at *28–29.

164. Black v. DMNO, LLC, No. 16-2708, 2018 U.S. Dist. LEXIS 84741, at *12–14 (E.D. La. May 21, 2018).

165. *See, e.g.*, Hart v. Rick's Cabaret Int'l, Inc., 967 F. Supp. 2d 901, 934 (S.D.N.Y. 2013).

166. *See* Thornton v. Crazy Horse, Inc., No. 3:07-cv-00251, 2012 U.S. Dist. LEXIS 82770, at *9 (D. Alaska June 14, 2012) (holding that a "VIP dance fee" is a tip for purposes of FLSA after consideration of these factors and other evidence).

167. *See id.*

168. *See* Benavidez v. Greenwich Hotel Ltd. P'ship, No. 3:16-CV-191, 2019 WL 1230357, at *8 (D. Conn. Mar. 15, 2019).

169. *See, e.g.*, *Thornton*, 2012 U.S. Dist. LEXIS 82770, at *9.

counted within the business's gross receipts and, thus, constitute tips.[170] The Southern District of New York, in *Hart v. Rick's Cabaret International, Inc.*, gave two reasons for this conclusion.[171] First, DOL regulations treat the inclusion of service charges in gross receipts as an important factor because the collection and distribution of the service charges characterizes them as such.[172] Second, this bright-line rule is preferable because using direct payments from a customer to an employee's wage for minimum wage purposes without counting the payments in the employer's gross receipts undermines the purpose of the FLSA and creates "intolerable problems of proof" in determining deductions.[173] Most district court opinions that treat service charges as tips in the adult entertainment industry turn on whether the service charges were included in the employer's gross receipts.[174]

3. Opinions that Challenge the Service Charge by Applying Substantive New York State Law

Minimum wage protections are not limited to those enumerated in the FLSA.[175] The federal minimum wage provisions are a floor, not a ceiling.[176] Several other states go beyond these federal protections,

170. *See Hart*, 967 F. Supp. 2d at 929 (explaining that whether a charge is included in gross receipts is a "critical issue" in determining whether a service charge is a tip).

171. *See id.* at 930.

172. *See id.*

173. *See id.* (holding that a service charge was a tip because cash payments to adult entertainers were not recorded in the gross receipts and distributed to employees by employers).

174. *See* Shaw v. Set Enters., Inc., 241 F. Supp. 3d 1318, 1329 (S.D. Fla. 2017) (holding that a service charge was a tip because fees were paid by the customers directly to the employees and the employer "did not collect, record, [or] redistribute the fees" to their employees); Verma v. 3001 Castor, Inc., No. 13–3034, 2016 U.S. Dist. LEXIS 164026, at *17–19 (E.D. Pa. Nov. 29, 2016), *aff'd on different grounds*, 937 F.3d 221, 233 (3d Cir. 2019) (holding that Penthouse Club was not entitled to service charge offset of its FLSA obligations because it did not include service charges in its gross receipts and did not redistribute service charges to its employees); Kimbrel v. Dea Corp., No. 3:14-CV-161, 2016 U.S. Dist. LEXIS 189316, at *30–32 (E.D. Tenn. Aug. 2, 2016) (holding that service charges are tips because they were not included in gross receipts and were not distributed to employees); *see also* Hughes v. Scarlett's G.P., Inc., No. 15-cv-5546, 2016 U.S. Dist. LEXIS 13886, at *11–15 (N.D. Ill. Feb. 5, 2016) (rejecting a motion to dismiss because employers pleadings alleging that they included service charges in their gross receipts and distributed them were contradicted by plaintiffs' pleadings); *cf.* Rosebar v. CSWS, LLC, No. 18 C 7081, 2019 U.S. Dist. LEXIS 136176, at *10 (N.D. Ill. Aug. 13, 2019) (holding that plaintiffs were not tipped employees under the FLSA because they received no wages except for tips from patrons). *But see* Ruffin v. Entm't of the E. Panhandle, 845 F. Supp. 2d 762, 769 (N.D.W. Va. 2011) (rejecting a motion to dismiss after finding that performance fees could constitute service charges when viewed in their most favorable light).

175. *See* Lockhart, *supra* note 31, §§ 22–23.

176. *See id.*

including Pennsylvania, New York, Hawaii, and California.[177] New York has the most comprehensive statutory protections for tipped workers.[178] Federal courts have applied New York substantive law in diversity jurisdiction cases.[179] The law in question, which expands on the federal definition of a service charge, is New York Labor Law 196-d:

> No 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 part of a gratuity or of any charge purported to be a gratuity for an employee. Nothing in this subdivision shall be construed as affecting the allowances from the minimum wage for gratuities in the amount . . . nor 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.[180]

The New York Court of Appeals held that this statutory language included service charges when the facts "show[] that employers represented or allowed their customers to believe that the charges were in fact gratuities for their employees."[181] The protection offered by this interpretation is much broader than the one established by federal law.[182] After 2011, New York law applied a "rebuttable presumption" that any service charge is "a charge purported to be a gratuity."[183] For example, the Southern District of New York held that a reasonable customer could interpret a service charge as a gratuity when "gratuity," "service charge," and "tip" were used interchangeably, contracts did not indicate whether

177. *See id.*

178. *See id.*

179. *See id.*

180. Hai Ming Lu v. Jing Fong Rest., Inc., 503 F. Supp. 2d 706, 709 (S.D.N.Y. 2007) (citing N.Y. LAB. LAW § 196-d (McKinney 2022)).

181. Samiento v. World Yacht Inc., 883 N.E.2d 990, 996 (N.Y. 2008); *see also* Spicer v. Pier Sixty LLC, 269 F.R.D. 321, 330 (S.D.N.Y. 2010) (holding that a reasonable person would have understood the service charge for banquet services to be a gratuity).

182. *See* Lockhart, *supra* note 31, §§ 22–23.

183. Salinas v. Starjem Rest. Corp., 123 F. Supp. 3d 442, 469–70 (S.D.N.Y. 2015). The Southern District of New York noted that, before 2011, the factors used to determine that a service charge is a tip included the following:

> (1) the font size and prominence of the notice; (2) the label used to denote the charge and whether such a label would confuse patrons . . . (3) whether purpose [of] the charge and manner in which the charge is calculated are described on the bill; (4) . . . portion of the charge that is being distributed to the service staff and informs . . . patrons to leave an additional payment as a tip; and (5) whether there exists a separate line for gratuity.

Id.

the service charge would be paid to the service staff, and the customers did not pay an extra gratuity.[184]

New York switched the burden of proof for determining the nature of a service charge from the employee to the employer when it recognized a "rebuttable presumption" that a service charge is a tip.[185] Also, New York guides employers by requiring them to distribute all gratuities to workers who provided the service.[186] Additionally, the employer must give adequate notice by "clear and convincing evidence" if the service charge is not meant to be a tip.[187] Even though the approaches to service charges are inconsistent, New York's broad interpretation is not precluded by federal law because the laws do not overlap fully.[188]

D. Service Charge as a Contract

Whether a service charge is a tip or not, the use of a service charge requires an exchange between a seller of goods or services and a buyer.[189] Service charges are part of a commercial transaction, and at least one Eleventh Circuit decision analyzed service charges through common law defenses to the enforcement of contracts, such as unjust enrichment and breach of contract, rather than analyzing the service charge through minimum wage law.[190]

1. Unjust Enrichment

Unjust enrichment—also known as "unjustified enrichment"—is a legal term of art that is used to bring a claim against a defendant for unfair

184. Copantitla v. Fiskardo Estiatorio, Inc., 788 F. Supp. 2d 253, 283 (S.D.N.Y. 2011); *see also* Kim v. Kum Gang, Inc., No. 12 Civ. 6344, 2015 WL 2222438, at *140 (S.D.N.Y. 2015) (reasoning that the contracts that referred to the service charge established "minimum 15% service charge" which implicitly solicited a larger tip).

185. *See Copantitla*, 788 F. Supp. 2d at 283.

186. *See* Davis v. 2192 Niagara St., LLC, No. 15-CV-00429A, 2021 U.S. Dist. LEXIS 109448, at *8–10 (W.D.N.Y. 2021) (citing N.Y. COMP. CODES R. & REGS. tit. 12, § 146-2.18(b) (2023)).

187. *See id.* at *9 (citing N.Y. COMP. CODES R. & REGS. tit. 12, § 146-2.18(a) (2023)) (providing guidance such as which statements should be included and what font size should be used to give adequate notice).

188. *See* Barenboim v. Starbucks Corp., 698 F.3d 104, 112 (2d Cir. 2012) (reasoning that the court "cannot ignore the textual difference between the FLSA and New York Labor Law"); *see also Davis*, 2021 U.S. Dist. LEXIS 109448, at *12 (noting that the court dismissed defendants' claim that it was impossible for defendants to comply with both federal and state law (referencing Davis v. 2192 Niagara St., LLC, No. 15-CV-00429A, 2016 U.S. Dist. LEXIS 98351, at *6–10 (W.D.N.Y. July 26, 2016))).

189. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1(b) (AM. L. INST. 2022).

190. *See* Holland v. Levy Premium Foodservice, 469 F. App'x 794, 795 (11th Cir. 2012).

or inequitable contractual deals.[191] The theory of unjust enrichment originates from the common law tradition, "natural justice," and equity.[192] The claim's ambiguity makes it difficult to pin down a specific definition.[193] Unjust enrichment is "enrichment that lacks an adequate legal basis" because it recognizes that not every unequal deal is per se invalid.[194] Generally, any alteration in legal ownership rights that is either ineffectively consented to or nonconsensual will constitute unjust enrichment.[195]

2. Breach of Contract

Breach of contract is the non-performance of an affirmative duty imposed by contract.[196] The obligor may owe their contractual duty immediately, or the duty may be conditioned on some future event.[197] When a contract is formed, it may create legal duties that one or both parties did not intend to make but still must execute to avoid breach.[198] Remedies for a breach may include compensatory damages—compensation equal to the value of performance—or specific performance—court-ordered execution of the agreement.[199] Employees, absent discharge of the contract or repudiation, have a cause of action for nonpayment of their salary or wages.[200]

3. The Curious Case of *Holland v. Levy*

Holland v. Levy is a circuit case that is unique in how it wrestles with whether a service charge is a tip.[201] The defendant, an owner of a sports arena that employed people to serve their concessions, posted a tipping policy that was visible to any reasonable customer and included notice of a service charge purporting to increase wages for all employees.[202] The

191. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1(b) (AM. L. INST. 2022).

192. *Id.* § 1(b).

193. *See id.*

194. *Id.*

195. *See id.*

196. 10 ARTHUR CORBIN & JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 53.1 (2022).

197. *See id.*

198. *See id.* § 53.2.

199. *See id.* § 53.6.

200. *See id.* § 53.16. When a party repudiates an agreement, it is called anticipatory breach; anticipatory breach is defined as a defense to performance for the non-breaching party "when a party repudiates prior to the date that the performance is due." *Anticipatory Breach*, LEGAL INFORMATION INSTITUTE, https://perma.cc/WER5-9ERJ (last visited Dec. 20, 2023).

201. *See* Holland v. Levy Premium Foodservice, 469 F. App'x 794, 795 (11th Cir. 2012).

202. *See id.*

notice further read that "if the attendant has provided a service that is of the highest quality, then please feel free to extend a personal gratuity."[203] However, the policy also warned that "[t]ip solicitation is a violation of our policies."[204] The plaintiffs filed suit alleging two breach of contract claims and one unjust enrichment claim.[205] The suit claimed that the employer did not compensate the employees an additional 20% alleged to be promised through the employer's imposition of the service charge.[206]

The Eleventh Circuit was not convinced by the plaintiffs' arguments. First, the Eleventh Circuit held that there was no breach of a unilateral contract under the policy.[207] The court reasoned that any unilateral contract was between the defendant and the patrons, but there was no unilateral contract between the defendant and its employees.[208] Next, the court held that there was no breach of contract for the plaintiffs as third-party beneficiaries.[209] The plaintiffs alleged that they had standing as third-party beneficiaries to enforce the contract between the defendant and the patrons because the contract was made for their benefit.[210] The court disagreed and held that the plaintiffs insufficiently alleged that the contract was made for their benefit.[211] Finally, the court held that the plaintiff's allegation that the retained service charges constituted unjust enrichment was a legal conclusion because there were no plausible findings that the employer-provided wages were unjust.[212]

III. ANALYSIS

Is there a good reason to attack the presumption that a service charge is not a tip? Yes, there are many public policy reasons to treat more service charges as tips. As a threshold matter, this Comment establishes that improving service charge regulations would support the FLSA's purposes because tipped workers are the group that the FLSA is meant to protect.[213] Therefore, whether a service charge is a tip is a policy question.[214] Policy should favor application of our laws in a way that affects their purpose, so service charge policy should ensure that tipped workers make a living wage.[215] Tipped professions have intertwined with federal minimum wage

203. *Id.*
204. *Id.*
205. *See id.* at 796.
206. *See id.*
207. *See id.*
208. *See id.*
209. *See id.* at 797.
210. *See id.*
211. *See Holland*, 469 F. App'x at 797.
212. *See id.*
213. *See infra* Sections III.A–III.B.
214. *See supra* Section II.A.3.
215. *See supra* Section II.A.3.

law since the tip credit was introduced over half a century ago.[216] Therefore, federal minimum wage law goals are inextricably intertwined with service charge policy goals.[217]

A. Who Were the Minimum Wage Regulations Supposed to Protect?

Federal minimum wage laws should be changed because the laws do not currently serve their intended purpose.[218] The current purchasing power of the minimum wage is nearly equal to the purchasing power of the minimum wage during the Great Depression.[219] A tip credit that takes an inadequate minimum wage and reduces it from $7.25 to $2.13 does not provide vulnerable workers any more meaningful relief than they had prior to the FLSA's enactment.[220] Going further, the shift away from the minimum wage law's original purpose to its current state began with the tip credit, which benefits employers through legislation intended to benefit employees.[221] An employee's standard of living would improve if they were provided a full minimum wage of $7.25 plus tips that would reduce the effect of a service charge eating away at the employees' compensation.[222] This policy change would serve the employee-protecting purposes of the FLSA.[223]

The FLSA's purpose was to protect employees, but the current scheme more effectively protects the employers.[224] The disparity between the FLSA's purpose and effect is a sufficient reason to explore alternatives to treating service charges as tips, but there are good policy reasons, as well.[225] Adequately paid employees are less likely to rely on government assistance, more likely to contribute to a functioning economy by circulating their increased discretionary income, and less likely to drop out of the workforce altogether.[226] Minimum wage law should be returned to its original purpose and ensure workers a comfortable standard of living.[227]

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216. *See supra* Section II.A.1.

217. *See supra* Section II.A.3.

218. *See supra* Section II.A.3.

219. *See 1938 United States Minimum Wage in Today's Dollars*, *supra* note 54.

220. *See* Jo C. McGinty, *Tips Don't Add Up for Most Waiters and Waitresses—The Numbers*, WALL ST. J. (Aug. 8, 2014, 4:10 PM), https://perma.cc/7YF2-VRX7.

221. *See* H.R. REP. NO. 93-913, at 2817 (1974).

222. *See id.*

223. *See id.*

224. *See Do Service Charges in Restaurants Make Sense?*, *supra* note 14.

225. *See generally* Doha Madani, *State of the Union: Economic Solutions for Middle Class*, MINARET, Jan. 29, 2015, at *3 (concluding that raising the take home pay for service workers would strengthen the economy).

226. *See id.*

227. *See id.*

B. Who is Impacted by the Classification of a Service Charge?

The law's current definition of a service charge as not a tip affects employees, employers, and consumers.[228] After years of debate in Congress about the minimum wage's harmful impact on small businesses, the current regulatory scheme favors employers.[229] In addition to the tip credit, employers can tack on service charges to a customer's bill to offset the employer's other costs.[230] Meanwhile, the tip credit, an immobile minimum wage, service industry jobs' nonexistent benefits, and the variability in customers' tipping preferences have all depressed service workers' actual wages.[231] Consumers also lose out because they must discern whether a service charge is a tip and, often, ultimately pay both because of the cultural pressure and norms of tipping.[232] Therefore, the current regulatory scheme for service charges negatively impacts employees and customers and only creates positive outcomes for employers.[233]

C. Can the Statutory Law and Regulations Which Create Current Service Charge Law Be Changed?

This Comment's general inquiry began as a broad question: "Is a service charge a tip?"[234] The answer is no, based on the relevant statutes, regulations, caselaw, and other considerations.[235] However, service charges should be limited by the courts, Congress, or the DOL because they can be abused to siphon off money from the employer's underpaid employees. Both the circuit courts and district courts agree that certain actions turn service charges into tips.[236] While the federal government could take more drastic action and eliminate the tip credit, raise the minimum wage to a living wage (or even a thriving wage), or offer a universal basic income, less drastic change is more feasible.[237] This Comment's remaining, narrow inquiry is how the law could supplement, change, or regulate the use of service charges to create an outcome more

228. *See Do Service Charges in Restaurants Make Sense?*, *supra* note 14.
229. *See supra* Sections II.A.1–2.
230. *See Do Service Charges in Restaurants Make Sense?*, *supra* note 14.
231. *See id.* The variation in customers' tipping preferences can be based on factors such as volume of business, customers' custom and preferences, whether the business includes a service charge, and a customer's ability to discern that a service charge is generally not a tip. *See id.*; *see generally* Azar, *supra* note 80, at 421–57 (explaining customers' tipping behaviors).
232. *See Do Service Charges in Restaurants Make Sense?*, *supra* note 14.
233. *See id.*
234. *See supra* Section II.B.
235. *See supra* Section II.B.
236. *See supra* Section II.C.
237. *See supra* Section II.C.

consistent with the FLSA and the broader policy goals of tipped industry oversight.[238]

D. How Can the Law Supplement, Change, or Regulate the Implementation of Service Charges?

The body of caselaw emerging from the district courts presents three solutions to the service charge confusion. First, the courts could create a totality of the circumstances test to determine whether a service charge is discretionary.[239] Second, courts could mandate that businesses who use service charges implement a "disambiguated service charge" that explains whether a service charge is a tip in a manner that would not confuse a reasonable consumer.[240] Third, courts could incorporate the New York state laws concerning service charges, which place the burden on the employers to prove that a service charge is not intended to be a tip.[241]

1. Totality of Circumstances Test for Service Charge to be "Discretionary"

As previously discussed, there is a wide range of judicial opinions as to what makes a service charge "discretionary" enough to constitute a tip.[242] Some courts have interpreted the issue narrowly and held that any deviation from a non-negotiable, automatic charge makes a service charge a tip.[243] Most courts hesitate to call a service charge a tip even if an employer has a routine process for waiving the charge at the customer's request.[244] Due to the lack of direction from appellate courts, district courts decide these cases based on their own discretion.[245] This lack of guidance has led to conflicting decisions that provide little guidance to other courts tasked with weighing the specific facts of a case.[246]

These jurisdictional inconsistencies can be resolved without eliminating the distinction between a service charge and a tip. An appellate court could remove these definitional inconsistencies by adopting a totality of circumstances test.[247] For example, the District Court of Alaska,

238. *See supra* Section II.A.2.
239. *See supra* Section II.C.1
240. *See supra* Section II.C.2
241. *See supra* Section II.C.3
242. *Compare* Rosell v. VMSB, No. 20-20857-Civ, 2021 U.S. Dist. LEXIS 116663, at *24–26 (S.D. Fla. June 22, 2021) (holding that if employer determines existence and amount of service charge then it is not a tip), *with* Lalic v. CG RYC, LLC, No. 18-20118-CIV, 2018 WL 5098883, at *6 (S.D. Fla. Aug. 13, 2018) (holding that consistency in application is determinative).
243. *See, e.g.*, *Lalic*, 2018 WL 5098883, at *6.
244. *See, e.g.*, Tom v. Hosp. Ventures LLC, 980 F.3d 1027, 1037 (4th Cir. 2020).
245. *See supra* Section II.C.
246. *See supra* Section II.C.
247. *See* Hart v. Rick's Cabaret Int'l, Inc., 967 F. Supp. 2d 901, 934 (S.D.N.Y. 2013).

in *Thornton*, identified factors to distinguish a service charge from a tip.[248] The purpose of this totality of circumstances test is to distinguish a service charge from a tip, but an employer may seize upon individual elements from the test to promote their interests if the test is too broad.[249] Therefore, a broad test would be as ineffective as the status quo.[250] Courts have generally agreed that the dispositive factor in determining whether a service charge is a tip is whether it can be removed at the customer or employer's sole discretion.[251] Therefore, this proposed test focuses on whether the service charge is "discretionary."[252]

These proposed factors related to "discretion" all center around the customer.[253] The customer's perception is crucial in determining whether the tip was discretionary.[254] The first proposed factor is whether the customer could choose whether to pay the service charge *in every instance*.[255] The first factor should be dispositive of the charge as a tip if the customer can choose to pay the charge in every instance.[256] If the customer does not require the employer or their agent's permission to remove the service charge, then it is not a service charge.[257] The second proposed factor is whether the customer can choose the amount.[258] A necessary component of the service charge is that it is fixed.[259] A variable service charge could not be automatic, which makes it a tip.[260] Thus, this factor, like the first, should also be dispositive if answered affirmatively.

The third proposed factor is whether the customer subjectively understands the fee as a tip or service charge.[261] The customer's subjective impressions do not compel a result by themselves but may be persuasive when combined with affirmative responses to other factors.[262] This factor is the only factor that does not rely on objective indicators but instead is

248. *See id.*

249. *See supra* note 242 and accompanying text. The discrepancy between *Lalic* and *Rosell* turns on interpretation of the word "discretionary." Lalic v. CG RYC, LLC, No. 18-20118-CIV, 2018 WL 5098883, at *6 (S.D. Fla. Aug. 13, 2018); Rosell v. VMSB, No. 20-20857-Civ, 2021 U.S. Dist. LEXIS 116663, at *24–26 (S.D. Fla. June 22, 2021).

250. *See supra* note 242 and accompanying text.

251. *See supra* Sections II.B–C.

252. *See Hart*, 967 F. Supp. 2d at 934.

253. *See id.*

254. *See id.*

255. *See* Tom v. Hosp. Ventures LLC, 980 F.3d 1027, 1037 (4th Cir. 2020).

256. *See id.*

257. *See id.*

258. *See* Benavidez v. Greenwich Hotel Ltd. P'ship, No. 3:16-CV-191, 2019 WL 1230357, at *8 (D. Conn. Mar. 15, 2019).

259. *See id.*

260. *See id.*

261. *See* Spicer v. Pier Sixty LLC, 269 F.R.D. 321, 330 (S.D.N.Y. 2010).

262. *See* Thornton v. Crazy Horse, Inc., No. 3:06–cv–00251, 2012 U.S. Dist. LEXIS 82770, at *9 (D. Alaska June 14, 2012).

based on the subjective impressions of the customer.[263] This factor can become more impactful to the final analysis if there is evidence showing that other consumers see the service charge as discretionary.[264]

The fourth proposed factor is whether a reasonable customer would see an advertised service charge as discretionary.[265] The analysis might include the following subfactors:

(1) the existence (or absence) of a written notice of the service charge outside the bill, such as on the menu;
(2) the specific language used within the notice of the service charge;
(3) comments made by the employee, employer, or other relevant parties;
(4) the type of tipped service being provided;
(5) custom; and
(6) whether the receipt has an additional line for a tip.

The last sub-factor may not be dispositive, but its absence would indicate that the service charge is meant to be a tip.[266]

All of these proposed factors focus on the presentation and context of the text of the service charge itself.[267] The fifth and final proposed factor is whether the customer successfully removed the purported service charge through the employer or their agent.[268] If answered affirmatively, this factor is likely to evidence a discretionary charge, meaning the charge will be considered a tip.[269] However, different customers may have different experiences at the same business, so this factor would require extensive factfinding to determine whether any given incident was a regular occurrence at the business where the purported service charge is being challenged.[270] A proposed totality of circumstances test will provide stability and uniformity in how service charges are implemented.[271]

263. *See* Salinas v. Starjem Rest. Corp., 123 F. Supp. 3d 442, 469–70 (S.D.N.Y. 2015) (referencing an older New York totality of circumstances test that examined service charges from the perspective of the customer).

264. *See* Tom v. Hosp. Ventures LLC, 355 F. Supp. 3d 329, 337–40 (E.D.N.C. 2018).

265. *See* Kim v. Kum Gang, Inc., No. 12 Civ. 6344, 2015 WL 2222438, at *140 (S.D.N.Y. 2015).

266. *See* Soliman v. SOBE Miami, LLC, 312 F. Supp. 3d 1344, 1351 (S.D. Fla. 2018) (listing factors that could be used to determine whether a service charge is intended to be discretionary or not).

267. *See id.*

268. *See id.*

269. *See id.*

270. *See id.*

271. *See id.* The lack of direction from the Supreme Court combined with the conflicted opinions in lower courts could be fixed by synthesizing the best aspects from all opinions into a totality of circumstances test with wide application. *See supra* Sections II.C.1–2.

2. Disambiguated Service Charges

The abundant service charge opinions concerning the adult entertainment context reveal an exception to the presumption that service charges are not tips.[272] When a customer pays a bouncer a cash fee to gain access to the dancers or gives the money to the dancers through more direct means, these payments are not included in the employer's gross receipts.[273] The DOL promotes accountability by labeling the service charges as tips that cannot count toward an employer's FLSA obligations unless they go through an intermediary who includes them in the gross receipts.[274] The DOL requires this gross receipt transparency from employers because they could otherwise misrepresent their FLSA contributions resulting from these service charges.[275] The employers must verify these payments in their gross receipts because to do otherwise invites dishonesty, and unverified payments allow employers to pay wages (and taxes) based on incomplete information.[276] The courts' reasoning regarding adult entertainment service charges should be applied to all service charges because they do not specify their intended use and are likely to mislead the customer.[277]

Employers would have an opportunity to commit fraud if they used uncounted cash toward their employer's FLSA, but they have a similar opportunity when they place an unspecified service charge on a bill for which the customer is owed no explanation and has no recourse.[278] The existence of the service charge may or may not be advertised to the customers and employees.[279] In almost all cases at the district or circuit court level, the employer does not specify the service charge's use.[280] At most, the service charge will include express non-binding language, such as "to be distributed to our team."[281]

While the requirement that all service charges be included in gross receipts is a step toward transparency, a gesture toward meeting minimum wage obligations in good faith does not go far enough toward furthering the FLSA's promises of a living wage.[282] If a business uses a non-

272. *See supra* Section II.C.2.

273. *See* Hart v. Rick's Cabaret Int'l, Inc., 967 F. Supp. 2d 901, 930 (S.D.N.Y. 2013).

274. *See* Shaw v. Set Enters., Inc., 241 F. Supp. 3d 1318, 1329 (S.D. Fla. 2017).

275. *See id.*

276. *See, e.g.*, Verma v. 3001 Castor, Inc., No. 13-3034, 2016 U.S. Dist. LEXIS 164026, at *17–19 (E.D. Pa. Nov. 29, 2016), *aff'd on different grounds*, 937 F.3d 221, 233 (3d Cir. 2019).

277. *See Hart*, 967 F. Supp. 2d at 929.

278. *See* Kimbrel v. Dea Corp., No.:3:14-CV-161, 2016 U.S. Dist. LEXIS 189316, at *30–32 (E.D. Tenn. Aug. 2, 2016).

279. *See id.*

280. *See supra* Sections II.B–C.

281. Compere v. Nusret Miami, LLC, 28 F.4th 1180, 1182 (11th Cir. 2022).

282. *See* H.R. REP. NO. 93-913, at 2817 (1974).

discretionary service charge distinct from tips, then the use of the service charge should be disclosed as well.[283] The proposed disclosure should be spelled out in writing on the menu or some other space which would be clearly visible to a reasonable customer.[284] Such a disambiguated service charge might look like the following:

> This restaurant includes a non-discretionary service charge of 20%. This service charge is not a tip, and patrons are encouraged to leave a separate tip for excellent service. While the service charge is not a tip, it is used to offset wage obligations, inflationary increases in the price of market products, and other customary costs of running a business.[285]

A mandatory disclosure of non-discretionary service charges that are not tips would solve several problems for consumers and employees. If the consumers know the service charge does not go to the employees, then most consumers in tipping industries will leave a separate tip.[286] Additionally, employees will not have the uncomfortable task of needing to explain to the consumers that a service charge is not a tip, but the consumer will know that they should pay them an additional tip because the service charge does not go to them.[287] A disambiguated service charge eliminates confusion for consumers and assure them that their servers are being fairly compensated.[288]

A disambiguated service charge would also align this service charge wrinkle in minimum wage law with traditional contract principles.[289] While the plaintiff in *Holland* failed to apply contract principles to a service charge, applying contract principles to service charges helps both customers and employees make sense of them.[290] The contract principle in question—mutual agreement to be bound—is more fundamental than the alleged unjust enrichment and breach of contract theories of liability raised in *Holland* because the central principle is whether both parties had enough information to create the intent to be bound.[291] Whether an agreement is analyzed as a consumer-employer relationship, an employer-

283. *See supra* Section II.C.1.

284. *See generally* Soliman v. SOBE Miami, LLC, 312 F. Supp. 3d 1344, 1351 (S.D. Fla. 2018) (including an example of a posted service charge which would leave very little ambiguity).

285. *See id.* This sample disambiguated service charge was based in part on the charge at issue in *Soliman*. *Id.*

286. *See* Lynn, *supra* note 80, at 79 (finding that customers' main motivation for tipping is to help servers); Azar, *supra* note 80, at 423–26 (demonstrating that a primary drive for tipping is employee welfare).

287. *See* Azar, *supra* note 80, at 426.

288. *See id.*

289. *See* Holland v. Levy Premium Foodservice, 469 F. App'x 794, 795 (11th Cir. 2012).

290. *See id.*

291. *See id.*

employee relationship, or even an employee-consumer relationship, all parties must know or be able to know the terms of the agreement for it to be enforceable.[292] An ambiguous service charge added to a mutual exchange with consideration opposes this basic concept.[293]

3. Shifting the Burden of Proof from Employee to Employer in Determining Whether a Service Charge is a Tip

Many states have already surpassed the federal system in protecting their most vulnerable, minimum wage workers.[294] New York has been the most effective by shifting the burden of proof from the employee to the employer when determining whether a service charge is a tip.[295] The presumption in New York is that service charges are tips unless the employer expressly proves otherwise through clear and convincing evidence.[296] The New York system has worked for over a decade and should be applied to the federal system.[297]

Several benefits are created by a rebuttable presumption that service charges are tips and that switches the burden to employers. First, the law would be consistent with the aims of the FLSA by protecting the tip income of the employees.[298] Second, the law will force employers to be clear about their intentions in implementing service charges.[299] Employers will have to label their service charges unambiguously as distinct from tips, which will cut down on customer confusion and ensure that employees do not receive fewer tips.[300] Finally, the employers set the prices for their businesses and have the most control over the agreement.[301] They should therefore be responsible for the ambiguity created by their service charge policies.[302]

IV. CONCLUSION

There is consistent, practical guidance from district court decisions that could be used to bring service charges into compliance with the purposes of minimum wage law under the FLSA.[303] Service charges

292. *See* RESTATEMENT (SECOND) OF CONTRACTS § 17 (AM. L. INST. 1981).
293. *See id.*
294. *See* Lockhart, *supra* note 31, § 2.
295. *See id.*
296. *See* Hai Ming Lu v. Jing Fong Rest., Inc., 503 F. Supp. 2d 706, 709 (S.D.N.Y. 2007) (citing N.Y. LAB. LAW § 196-d (McKinney 2022)).
297. *See id.*
298. *See supra* Sections II.A.1–2.
299. *See supra* Section II.C.2.
300. *See supra* Section II.A.4.
301. *See supra* Section II.A.3.
302. *See supra* Section II.A.3.
303. *See supra* Sections II.A.1–2.

represent the most recent roadblock that stands between tipped employees and a living wage.[304] While service charges may be a "legal grey area," customers' confusion about their purpose is not.[305] In fact, employers have a black and white incentive to siphon off their employees' tips to, at best, meet their minimum wage requirements and, at worst, augment their profits at their employees' expense.[306]

Service charge jurisprudence does not have to be ambiguous. First, courts could provide some much needed consistency by creating a totality of circumstances test that is likely to distinguish whether a service charge was a tip.[307] Second, the court or the legislature could implement a requirement that all service charges be clearly distinguished from tips to reasonable customers, unless the employer intends them as a tip.[308] A disambiguated service charge would reduce the likelihood that employees' tips are affected by the service charge, and bring these regulations in line with traditional contract principles.[309] Finally, courts or legislatures could simply implement New York's "rebuttable presumption" on the federal level.[310] If the federal government adopted New York's successful, employee-friendly legislation, it would provide the consistency of a totality of circumstances test with the clarity of a disambiguated service charge.[311] However, any one of these remedies would be a marked improvement over the soft abrogation of the FLSA through government inaction on service charges.

304. *See supra* Part II.
305. *See supra* Sections II.3–4.
306. *See supra* Sections II.3–4.
307. *See supra* Section III.D.1.
308. *See supra* Section III.D.2.
309. *See supra* Section III.D.2.
310. *See supra* Section III.D.3.
311. *See supra* Section III.D.3.