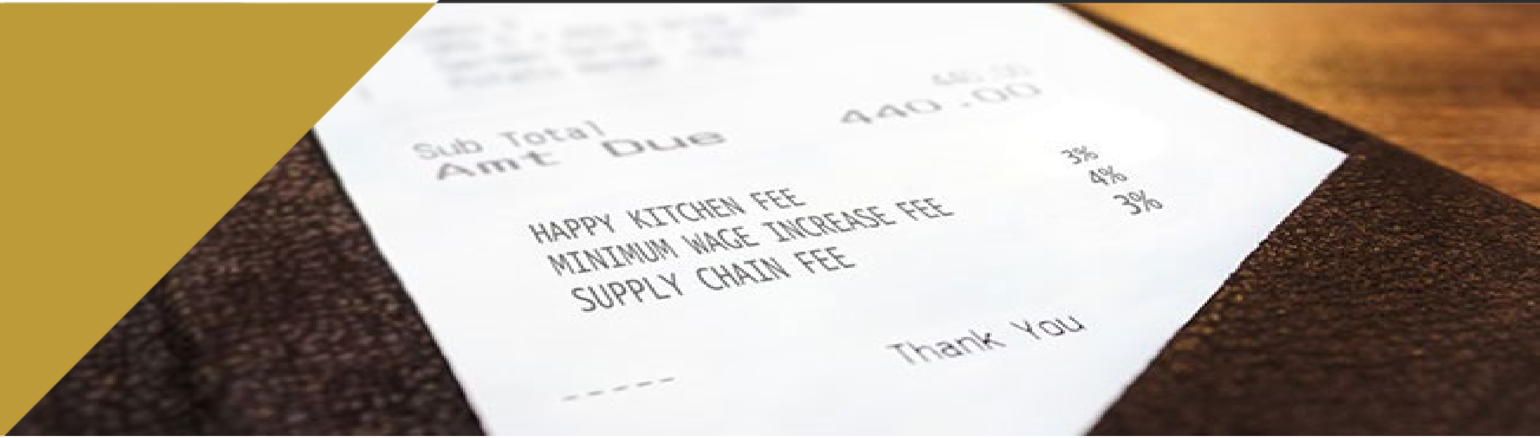
Please note

This document is intended for general information purposes only. It does not constitute legal advice or create an attorney-client relationship. This document is based on the most current information at the time that it was prepared. Laws and/or other circumstances may have changed since the publication of this document. The reader should consult with knowledgeable legal counsel for the most current information and to determine how applicable laws apply to specific facts and situations.

GT GreenbergTraurig

www.gtlaw.com



Surcharges & Related Fees: Tips & Traps for Restaurateurs

JULY 14, 2022

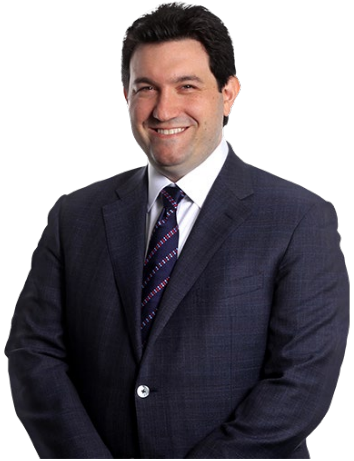
GT GLOBAL RESTAURANT INDUSTRY GROUP

Today's Presenters

Riley Lagesen
Shareholder & Corporate Chair of the Global Restaurant Industry Group,
Greenberg Traurig

Alicia Sienne Voltmer
Shareholder

Greenberg Traurig



Jason Jendrewski
Shareholder

Greenberg Traurig

A Brief History of Surcharges in the Restaurant Industry:

- 2008: San Francisco's Health Care Security Ordinance goes into effect, requiring businesses to provide health care expenditures for employees. Many restaurants began passing along the cost to customers in the form of surcharges. Los Angeles and San Diego soon followed.
- November 29, 2012: Organized fast-food strike in New York City as over 100 workers from McDonalds, Burger King, Wendy's, Domino's, KFC and Pizza Hut walked off their jobs. Federal minimum wage at the time was (and still is) $7.25 an hour.
- 2013: Fast food worker strikes in multiple key US cities; first national fast-food workers strike takes place on August 29
- 2013/2014: More nationally-coordinated fast food worker strikes and the movement adopts "Fight for $15" name
- 2014 to 2016: In reaction to the "Fight for $15" efforts, many cities and states began dramatically raising minimum wages, including New York City, Seattle, Los Angeles, San Francisco and Portland.

Behind the Curtain: The Efforts of Unions to Exploit the Restaurant Industry to Increase Union Membership

- What we are experiencing today is the product of a union led initiative going back more than a decade to exploit restaurants to drive sagging union membership.
- The union organizers behind the "Fight for $15" campaign solely focused their efforts on franchised fast-food restaurants. Not a single protest involved non-franchised or full-service restaurants. Yet, the impact of the dramatic wage increases has significantly impacted all restaurants, including company-owned and full-service restaurants.
- Currently, unionization efforts are gaining momentum around the country. In addition, The Fast Food Accountability and Standards Recovery Act, AB 257 (the "FAST Act") is pending in California and being promoted by unions. It would have a material impact on the California restaurant industry, with an expected ripple effect into many other states and cities.

Restaurants Adapt to Changing Times

- In or around 2015, restaurants in many markets, especially those with higher wages and no tip credits, began exploring new compensation and business models to account for rising costs and wages.
- In 2015, Union Square Hospitality Group announced it was eliminating tipping at all of its restaurants under a model they called "Hospitality Included." Many other restaurants also experimented with eliminating tipping.
- Other restaurants, as opposed to significantly raising menu prices, began adding surcharges to customers' tabs, typically charged as a percentage of the transaction.

Surcharge Experimentation Take-Aways from Early Adopters

Several of our clients began experimenting with services charges as early as 2016. The primary reason was to offset the increased labor cost as opposed to raising menu prices. West coast states, which do not have a tip credit, and, at the time, were limited by tip pooling restrictions, were most impacted.

The Initial Reaction to Surcharges: Headlines and Media Quotes

- “A new ‘living wage surcharge’ added by a popular restaurant chain in the Portland area is catching some diners off guard.”
- “Is a surcharge for the new minimum wage going too far?”
- “There's a Minimum Wage Controversy on This Restaurant Receipt.”
- “We’re [on] the front-lines and having to talk to the customers and explain what the charge is, even if we don't agree with it, yeah, I’d like them to come down here and talk to the customers themselves.”
- “Our locations add a Living Wage Charge to offset the cost of Portland's increasing minimum wage. This is not a charge for services provided. The living wage charge directly offsets our payroll costs as a credit that goes straight into an account that is in the direct labor category and is not revenue to the company. RUI made the decision to add the Living Wage Charge in lieu of making a significant increase to menu prices which would have resulted in higher costs to our guests.”
- “Are rising rent costs across the District forcing restaurants to tack on a surcharge to your tab - or even worse and causing them to shut their doors? A Northwest D.C. restaurant has found a discreet way for patrons to help foot the increasing cost to do business.”
- “The minimum wage surcharge tacked onto the bill at the end was poor form and tells me the owners object to paying their employees a living wage - that's not the type of business I choose to support.”

Surcharges Today in Early Adopter Markets

- In early adopter cities, controversy over such charges has generally dissipated over the years. A substantial number of restaurants use surcharges and customers seem to have accepted them as the new normal.
- Given the impact of Covid-19 on the restaurant industry, coupled with the current economic environment with historically high inflation, increased labor costs, and labor challenges, customers seem to be more accepting of such charges as a tool to maintain business viability.

Types of Surcharges

- Money stays with the business (as a direct offset to increased costs)
- Money goes to employees (i.e., "*Happy Kitchen Fee*" where money goes to "back of house" employees and is not retained by the business)
- A portion of the money stays with the business; a portion of the money goes to employees

Most restaurants use surcharges as a direct offset to increased costs, as opposed to sharing the money with employees. However, a number of restaurants have implemented such fees for the benefit of employees, especially "back of house" employees who typically do not receive gratuities to bolster their wages.

Key Practical Considerations in Adding a Surcharge

- Surcharge or price increase? Which is the best path for you?
- How big is the surcharge?
- How will your customers react?
- How will the surcharge be explained to your customers?
- How will you train your employees to explain the surcharge to customers?
- Is it worth the risk of alienating customers and creating employee discomfort?
- Is it worth the potential legal risk?

Key Legal Considerations in Adding a Surcharge

- Are surcharges permitted in your jurisdiction? Does your state or city have an applicable statute?
- Is notice to customers required? If so, what does it need to say?
- Is notice to employees required? If so, what does it need to say?
- Must the fee collected be paid 100% to employees?
- Does the fee impact the calculation of overtime?
- Do you have to pay sales tax on the fee you implement?

Beware of Local Laws

- New York City generally prohibits restaurants from imposing surcharges!
- The Rules of the City of New York: § 5-59 Restaurant Surcharges.

(a) A seller serving food or beverages for consumption on the premises may not add surcharges to listed prices. For example, a restaurant may not state at the bottom of its menu that a 10 percent charge or a $1.00 charge will be added to all menu prices.

(b) A seller may impose a bona fide service charge (such as an added charge for two persons splitting one meal, or a per person minimum charge), if the charge is conspicuously disclosed to the consumer before the food is ordered.

(c) In this section, the term "surcharge" does not include tax.

Beware of Local Laws

NYC Consumer and Worker Protection

Inspection Checklist:
Restaurant Surcharges and Mandatory Gratuities

Do you operate a restaurant?

Use this checklist to learn what our inspectors look for and help avoid violations. All businesses also must comply with the General Retail Inspection Checklist, which is included at the end for easy reference.

For your convenience, each Requirement includes the relevant section of law and/or rule, so you can refer to it for more information. The KEY below describes the legal citations and symbols used in this checklist.

KEY
RCNY: Rules of the City of New York **§:** Section

Requirement		Do you meet this requirement?
1	Restaurants cannot charge a surcharge or other fee in addition to listed food or beverage prices. **Tip:** Examples of surcharges or other fees include a 5% living wage fee, 20% administrative charge, or 15% mandatory gratuity. **Tip:** "Surcharge" does not include tax. **6 RCNY §5-59(a), 6 RCNY §5-59(c)**	☐ Yes
2	Restaurants may charge a bona fide service charge, but only if the charge is conspicuously disclosed to consumers before food is ordered (e.g., on a sandwich board, menu, or sign). **Tip:** Examples of bona fide surcharges include a charge to split a single meal on multiple plates; a minimum per person charge; or a mandatory gratuity for parties of eight or more. **Tip:** It is a violation to include the disclosure on the back of a menu or hidden in the design of a menu or on a sign that is blocked from public view or in a location where consumers cannot see it. **6 RCNY §5-59(b)**	☐ Yes

Litigation Risks and Litigation Examples

- Unfair business practices/consumer protection lawsuits (consumer class actions, typically regarding a failure to properly disclose the charge (dozens of actions filed around country))
- Employee lawsuits (i.e., 2019 wage theft lawsuit against Seattle Melting Pot franchisee, alleging restaurant pocketed surcharge proceeds that customers believed were intended for staff)
- Administrative/Regulatory Action (i.e., Healthy San Francisco, SF City Attorney enforcement action in 2013)
- Antitrust lawsuits (i.e., 2015 Los Angeles lawsuit alleging price fixing against multiple restaurants that added healthcare surcharges)

Best Practices – Clear Disclosure

- If a surcharge will be applied above & beyond the listed menu prices (other than sales tax), **CLEAR DISCLOSURE** should be made in advance of purchase:
    a. *Counter service restaurants*: post a prominent sign at the counter or notice on the menu board (if any).
    b. *Sit-down restaurants*: disclose any surcharge prominently on printed menus or on the digital version accessible via QR code.
    c. *Bars/bar areas*: prominently disclose on any bar menus, printed or digital.

- In all cases, train staff to mention surcharge to customers prior to ordering.

Best Practices: Disclosure Honesty

- Disclosures should be honest and not misleading to customers (or your employees).
- **False or misleading surcharge disclosures can lead to significant liability**.
- Specifically, do not use any misleading descriptors of the charge that suggest the surcharge is going somewhere it isn't.
  - For example, "service charge", "happy kitchen fee," and "back of the house fee" suggest that the surcharge may be going to employees. If that is not the case, you are inviting potentially expensive litigation from both consumer and employee class action litigators.

Best Practices: Disclosure Simplicity

- Keep disclosures true and simple. Resist going into unnecessary detail, as the more detail, the more that can be challenged, especially if inaccurate.
- If surcharge is genuinely being used to account for increased costs, keep disclosure as general as “a surcharge is being added to help offset increased costs to the business.”

Best Practices: Check Local Requirements

- Comply with any disclosure requirements that may be required by law, such as statements that the surcharge is not a gratuity and will not be distributed as gratuities to the employees
- For example, the New York State Hospitality Industry Wage Order requires employers to notify customers that surcharges are <u>not</u> gratuities or tips.
  - "The administrative charge is for the administration of the event, is not a gratuity, and will not be distributed as gratuities to the employees who provided service to the guests."
  - The statement must be in at least 12-point font and should appear in any contract with the customer as well as on any menu or bill listing prices.

Limit Surcharges to Cover Increased Costs

- Surcharges are typically used to cover a portion of the businesses' increased costs, and not as an actual or potential profit center.
- The use of surcharges of a profit center increases the risk of expensive litigation or regulatory action (e.g., "Healthy San Francisco" enforcement action, in addition to consumer and potentially employee class actions).

Summary Takeaways

- Surcharges are the new normal. We can expect an increasing number of restaurants (in jurisdictions that allow surcharges) to use them for the foreseeable future, to avoid raising menu prices and for other reasons.
- We expect more regulatory scrutiny of surcharges at the state and local level, in addition to more litigation activity. Class action attorneys are often highly incentivized to bring cases based on the laws that support potential causes of action.
- Thoroughly consider the pros and cons of surcharges before implementing them.
- Always consult with counsel prior to implementing any surcharges.

Questions?