California Employers Using Unlimited PTO Policies may Lose it: California Court Rules that some Unlimited PTO Policies are Unlawful "Use it or Lose it" Policies

By Autumn L. Moore, Guillermo M. Tello / Apr 08, 2020

Over the past several years, so-called unlimited or flex paid time off (“PTO”) policies have grown in increasing popularity. A recent California Court of Appeal opinion may change how employers communicate and implement these policies. Under these unlimited or flex PTO policies, there is no accrual of minimum vacation time and no maximum cap on the amount of time an employee could take. In other words, employees can take as little or as much time off as their job responsibilities permit. Significantly, there is no accrual of hours or banks of time to track, and there is no cash-out value to pay when the employment relationship ends. The popularity of these policies has grown among employers because they alleviate administrative burdens and can control costs when the employment relationship ends.

Until recently, no California authority had addressed whether a nonaccrual, unlimited PTO policy is subject to or in violation of section 227.3 of the California Labor Code, which requires payment of “accrued” vacation wages upon termination. This changed on April 1, 2020, when a California Court of Appeal issued a ruling in *McPherson v. EF Intercultural Foundation, Inc.* (Case No.: B290869) that could adversely impact employers with unlimited or flex PTO policies. The Court ruled an employer’s unwritten policy of providing “unlimited” vacation was really a de facto “use it or lose it” policy for which vacation wages were owed when the employment relationship ended. The *McPherson* Court was keen to point out that their holding “by no means” prohibits all unlimited PTO policies in California. However, the Court noted that any such unlimited or flex PTO policies must be consistent with the Labor Code and governing case law.

The ruling:

Although vacation policies are not mandatory in California, if an employer does choose to implement one, it must comply with Labor Code Section 227.3, which requires the employer to pay as wages any “vested” vacation time a terminated employee has accrued but not used. The *McPherson* case involved three former exempt employees who sued their former employer, EF Intercultural Foundation (“EF”), a study-abroad placement company, for unpaid vacation wages. The trial court awarded vacation wages to the three employees finding that EF never told them that they had unlimited paid vacation, that EF had no written policy or agreement to that effect, nor did its employee handbook cover the plaintiffs. The Court further found that EF’s unwritten policy had an implied limit, as employees were expected to take between two to six weeks of vacation. In finding for the plaintiffs, the trial court termed EF’s policy of providing vacation time that did not accrue as an “undefined” rather than an “unlimited” vacation policy. The court reasoned that “offering vacation time in an undefined amount simply presents a problem of proof as to what the employer’s policy was,” and not a loss of entitlement to receive vacation wages due under Labor Code section 227.3 at the end of their employment relationship.

On Appeal, the Court noted that under California law employers have no obligation to provide vacation time and, if they elect to provide such time, “certainly may limit an employee’s ability to earn vacation.” However, once vacation time is offered, “any limit on an employee’s entitlement to it must be expressed in a clear, written policy from the get-go.” Significantly, the Court acknowledged that an employer’s ability to limit an employee’s ability to earn vacation indefinitely, where vacation time is offered, remains an open question under California law. Conceding this issue remains undecided in California, the Court found it did not then need to decide whether vacation wages are earned under an unlimited policy because EF’s policy was not an unlimited vacation policy. Instead, in agreement with the trial court, the Court ruled that “an employer cannot avoid section 227.3 by leaving the amount of vacation time undefined in its policy while impliedly limiting the time actually available for approval.” Based on these findings, the Court held EF’s plan was subject to section 227.3.

The future of unlimited or flex PTO policies:

The *McPherson* Court, in expressing that their holding was not intended to preclude true unlimited or flex PTO policies, provided the following guidance to employers seeking to implement a policy that would not trigger the provisions of section 227.3:

1. The policy must be in writing;
2. The policy should clearly provide that employees’ ability to take paid time off is not a form of additional wages for services performed, but part of the employer’s promise to provide a flexible work schedule—including employees’ ability to decide when and how much time to take off;
3. The policy should spell out the rights and obligations of both employee and employer and the consequences of failing to schedule time off;
4. In practice, the policy should allow sufficient opportunity for employees to take time off, or work fewer hours in lieu of taking time off; and
5. The policy must be administered fairly so that it neither becomes a de facto “use it or lose it policy” nor results in inequities.

In light of this guidance, all employers, not just California employers, should review their current intended unlimited or flex PTO policies to ensure legal compliance.

If you have any questions regarding the *McPherson* ruling, or regarding any vacation/PTO policies, please contact Guillermo Tello (gtello@ClarkHill.com), Autumn Moore (amoore@clarkhill.com), or another member of Clark Hill’s Labor and Employment Law practice group.

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