Dangers Of Poorly Defined Vacation (PTO) And Application Of California Law To Non-Residents Addressed By Appellate Court

Insights
10.02.20

California law does not require employers to provide their employees with paid vacation. However, if an employer has a policy providing its employees with paid vacation, the administration of the benefits is strictly regulated by section 227.3 of the California Labor Code. The law provides that, if an employer provides vacation, "all vested vacation shall be paid to [employees] as wages at [their] final rate," except as provided in a collective bargaining agreement. The California Labor Commissioner is empowered to conduct enforcement proceedings including issuing citations and conducting hearings on vacation claims to make sure that employers administer them according to the "principles of equity and fairness."

Recent Case Provides Clear Warning To Employers

A recent appellate decision provides a warning that employers should accurately define all accrued leave programs, whether called "vacation" or PTO programs. This decision came down in the middle of the COVID-19 shut down, during which conditions resulted in emergency legislation providing mandatory paid leaves of absence for workers impacted by the pandemic that employers are required to administer. The generous paid leave benefits supplied by the federal and California government increased the burden of administering paid leave benefits. Adding to the administrative burden during the pandemic, employers have been permitting many employees to use existing sick pay, accrued vacation, or accrued PTO benefits to supplement the emergency sick leave and family leave benefits when exhausted. Thus, this decision was handed down at an important time when paid leaves of all kind are being scrutinized.

The *McPherson v. EF Intercultural Foundation, Inc*. case involved an appeal of a bench trial ruling where the trial court entered judgment awarding vacation to three area manager employees, who were told they were not entitled to the specific accrual schedules enjoyed by other employees. The employer defended against the unpaid vacation allegations, among other things, by contending that the vacation was *unlimited*, therefore did not accrue. It thus argued that nothing was ever due on separation.

The trial evidence established that the employees were told they could take vacation during the non-busy season. Although they were paid vacation when they took it, they were never specifically told that their vacation was *unlimited*. The court held that the employer's purported "unlimited" paid time off policy violated Labor Code Section 227.3 based on the particular facts of that case.

Importantly, the court reasoned that the evidence established the employer "expected plaintiffs to take vacation in the range typically available to corporate employees (such as two to six weeks), not an "unlimited" amount—for example, more than would be available under a traditional accrual policy." The record further established the plaintiffs were only told that, "as area managers they could take paid vacation outside of the busy season, but their vacation did not accrue."

The only other things the employer told the plaintiffs was that "(1) they had to notify their supervisor before taking time off and ensure they could complete their work, and (2) they did not need to track their days off in the online system because they did not accrue vacation." Yet, despite all this, management never specifically advised the plaintiffs that the reason they did not accrue vacation was "because they — unlike employees subject to the accrual policy — could take as much vacation as they wanted."

Bona Fide Unlimited Policies Not Invalidated By Decision

The court made clear that it was not holding California law prohibited "truly unlimited time off policies." The court reasoned that an unlimited time off policy may not trigger section 227.3 where it does the following in writing:

- clearly provides that employees' ability to take paid time off is not a form of additional wages for services performed, but perhaps 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;
- spells out the rights and obligations of both employee and employer and the consequences of failing to schedule time off;
- in practice allows sufficient opportunity for employees to take time off, or work fewer hours in lieu of taking time off; and
- is administered fairly so that it neither becomes a de facto "use it or lose it policy" nor results in inequities, such as where one employee works many hours, taking minimal time off, and another works fewer hours and takes more time off.

The court added that, if such a policy falls within the foregoing considerations, the policy "very well may not constitute deferred compensation for past services requiring payment on termination under section 227.3."

To illustrate its point, the court further gave an example of a bona fide unlimited policy where law firms permit their attorney associates to take unlimited amounts of paid vacation as long as they satisfy the annual billing standards established by the firms. This would permit some productive employees to take off far more paid vacation per year than what normally would be available to full-time law associates in the industry.

Release In Severance Agreement Invalid

There were other aspects of the *McPherson* decision, turning on well-established principles of California law, that further limited both the employer's defenses and the scope of one plaintiff's

California law, that further limited both the employer's defenses and the scope of the plaintiff's claim. The defendant, among other things, pointed to a severance agreement signed by an employee as barring any right to seek the alleged unpaid, accrued vacation.

Although this part of the decision was not published, the court rejected the release in the severance agreement because the vacation issue was not in dispute at the time of the severance agreement. The court cited Labor Code section 206.5 that states "An employer shall not require the execution of a release of a claim or right on account of wages due, or to become due, or made as an advance on wages to be earned, unless payment of those wages has been made. A release required or executed in violation of the provisions of this section shall be null and void as between the employer and the employee."

Non-Resident Employee Claim Limited

An important published section of the decision was the issue of whether one of the plaintiffs could seek unpaid vacation during the period she was a non-resident of California. The record established that Donna Heimann was not a California wage earner from mid-2005 until her retirement on October 2014. Interestingly, she reportedly described herself as "relocating" to California every summer.

Notwithstanding, the record did not support a finding that she was a part-time resident of California, as both she and the trial court seemed to imply. The court examined, among other things, the California Revenue and Taxation Code, which provided that a resident is an individual in the state "for other than a temporary or transitory purpose" (Rev. & Tax. Code, § 17014, subd. (a)(1)). An individual in California "to complete a particular transaction, or perform a particular contract, or fulfill a particular engagement," requiring her presence here for "a short period," is considered in the state for a temporary or transitory purpose (Cal. Code Regs., tit. 18, § 17014, subd. (b)).

In its reasoning, the court gave an example of an executive who lives in New York with his family but travels to California for business for one or two weeks at a time, for a total of six weeks a year, as a nonresident. The court reasoned that, essentially, "the state with which a person has the closest connection during the taxable year is the state of his residence." To that end, the court found that "Heimann gave up her status as a California resident when she moved to Virginia," pointing to the following:

- She lived in California during the summer for a particular, limited business purpose — to oversee student trips for the summer program.
- The company paid for her to stay in a hotel or a dormitory for the summer. She did not maintain a home in California or own any property in California.
- She had her mail temporarily forwarded from Virginia to California each summer, but there was no evidence she permanently changed her address or residence status.
- She gave up her California driver's license and registered to vote in Virginia after she moved.

- She opened and maintained a California bank account as part of her job, but nothing in the record shows she had a personal bank account in California after she moved.
- There is no evidence that she maintained any close ties to California after she moved so that she could be considered a "resident" for part of the year.

The court ruled that, "at a minimum … section 227.3 does not apply to work Heimann performed in Virginia or in any other state outside of California." The court further ruled that vacation accrued while Heimann was not a resident of California was not actionable under Section 227.3 and, on this basis, remanded the case to the trial court for recalculation of damages to exclude damages related to the non-residency period.

The *McPherson* decision clearly signals that California will, in fact, limit its jurisdiction over certain non-resident wage claims, with the exception of overtime claims by non-residents, which continue to be closely monitored.

Takeaways For California Employers

Although the *McPherson* decision limited the ability of a non-resident employee to bring vacation claims for vacation accruing while the employee was not residing in California, it also makes it vital for employers to provide employees who do not accrue vacation with written agreements or policies unambiguously excluding them from participation in accrued paid leave programs. The use and administration of accrued vacation in California continues to be tracked closely by the courts, and it will include the requirement that exclusions from vacation accrual programs should be carefully placed in a writing satisfying factors set forth by the *McPherson* decision, including implementation consistent with the policy.

Indeed, employers can no longer assume that employees who receive paid vacation or PTO outside of a written vacation policy will not be deemed to have unlimited vacation benefits. Rather, with poorly implemented or unwritten policies, the courts may find that such employees may have accrued *some* vacation benefits that cannot be forfeited upon termination. Employers should therefore retain legal counsel to assist with any vacation policy, whether accrued or unlimited, to help the intent of the policies survive a challenge by employee advocates.

For more information, contact the authors here or here.

Related People

John K. Skousen
Senior Counsel
214.220.8305
Email

Service Focus

Wage and Hour