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"Unlimited Vacation" Policies Gaining Traction

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In California and elsewhere, several companies have moved away from traditional vacation accrual policies to an unlimited vacation (or "honor system") policy, and many more companies are seriously considering such a move. These new policies arguably give employees relatively greater freedom to take vacation as needed, subject to the demands of the business. Moreover, the process and burdens of accruing leave on the books and tracking absences are eliminated. An unlimited vacation policy may be an attractive option for employers seeking to simplify the administration of their vacation benefits and minimize costs, while at the same time providing employees with greater flexibility to manage their work schedules and personal time. However, implementation of such a policy has inherent challenges and is not without legal risk.

Issues with Traditional Vacation Policies

Employers are not required to provide employees with vacation benefits. Once they do, state law obligations are triggered, and they can be onerous. For example, California law prohibits both "use it or lose it" vacation policies and unreasonable caps on vacation accrual, requires vacation benefits to vest as labor is performed, and prohibits forfeiture of vested vacation benefits upon termination. These requirements significantly impact the administration of traditional vacation benefits.

The most common vacation policy is one in which employees accrue vacation (or "paid time off," i.e., a combined vacation/sick bank of leave) benefits pursuant to a set formula (e.g., two weeks of vacation per year). In California, an employer offering this type of vacation benefit must allow daily accrual of vacation, cannot impose an unreasonable cap on accrual,[1] and must pay out all unused, accrued vacation upon termination of employment.

Traditional vacation policies work fairly well for non-exempt employees. Because non-exempt employees are only compensated for hours worked, they have little incentive to take vacation unless they have some form of paid vacation leave entitlement. In addition, tracking accrued vacation leave benefits for non-exempt employees is a relatively simple exercise because such employees must record the time they work, and tracking systems today are very facile.

However, traditional vacation policies can be more cumbersome with respect to exempt, salaried employees, who are compensated for the work they perform and not by the amount of time they spend doing it. Regardless of whether an exempt employee works 10 hours or 60 hours during a workweek, the employee is still generally entitled to be paid his or her full salary for that workweek. Because they are not paid based on time worked, exempt employees are also not required to "punch

a clock," and employers are also strictly limited in making deductions from the salaries of exempt employees. While full day and partial day deductions from vacation balances of exempt employees are generally permitted under federal law, state law may restrict the ability of employers to make partial day deductions from vacation balances.[2] The lack of a predefined work schedule gives exempt employees a substantial degree of flexibility and responsibility in managing their work assignments and personal time but also makes it difficult for employers to know when exempt employees are working and when they are on leave. This places a significant burden on employers to accurately keep track of vacation balances for exempt employees.

Growing Trend of Unlimited Vacation Policies

For these and other reasons, some employers have moved away from traditional vacation policies and implemented unlimited vacation policies for exempt employees. Employees do not accrue vacation days or maintain balances, and they simply take vacation time when they wish but subject to the requirements of their job. Employers do not have the administrative burden of keeping track of accrued vacation and do not pay for unused, accrued vacation upon termination (where state law compels such a payment) because employees have no accrued vacation time. In theory, these policies are optimal because exempt, salaried employees should be responsible and accountable enough to manage their own workload and vacation time effectively.

Potential Benefits of Unlimited Vacation Policies

Unlimited vacation policies can offer many potential advantages for employers and covered employees. First, unlimited vacation gives covered employees more freedom and flexibility to take time off without worrying about whether they have sufficient accrued vacation to cover planned or unplanned absences. Second, keeping track of vacation is eliminated for employers. Employers no longer have the administrative burden of maintaining accurate records of vacation balances for covered employees, chasing employees to properly record their vacation time, etc. Third, there is no direct financial cost to the employer. Because no vacation accrues, no unused, accrued vacation is paid out upon termination of employment. This avoids the potential problem of paying a large lump sum payment for unused vacation (which may or may not have been accurately recorded in the first place) at termination. Fourth, implementation of such a policy may foster trust and a deeper feeling of loyalty from covered employees, a morale boost and greater productivity.

Potential Burdens of Unlimited Vacation Policies

Despite the benefits, unlimited vacation policies may also impose burdens and create legal risks. For the reasons stated above, unlimited vacation policies are largely ill-suited for, and offer little or no benefit to, non-exempt employees who do not receive pay during vacation without some form of paid leave benefit. Thus, employers with a heavy non-exempt employee population may conclude that an unlimited vacation policy is not suitable for their organization. That said, employers may certainly limit application of such a policy to a small group of employees (e.g., all exempt employees, or an even smaller group of high-level executives).

An unlimited vacation policy can also be susceptible to exploitation by employees. Employees may view "unlimited" in a literal sense and may unreasonably attempt to take excessive vacation. For this reason, it is important to properly communicate to employees that they are responsible for satisfactorily performing their job duties regardless of the amount of vacation they use and can be disciplined and even terminated for not meeting the requirements of the job. Employers should certainly require employees to obtain management approval prior to taking vacation time, but they need to be fair and consistent in the administration of their

vacation policies. A clear written policy is essential in this regard.

Another challenge with respect to unlimited vacation policies is coordination with other paid and unpaid leave benefits. In addition to vacation, most employers offer and/or are subject to a number of leave benefits, including sick leave, family and medical leave, military leave, pregnancy or maternity/paternity leave, which often overlap. An employer must consider in advance and clearly set forth how it will deal with lengthy leaves of absence in terms of which policies will be impacted, how long the employee will be entitled to paid leave benefits, and whether and to what extent paid leave benefits will be coordinated with other forms of wage replacement benefits (e.g., disability benefits or sick leave). In other words, "unlimited" vacation will likely need some limits.

Lack of fair, consistent administration of policies may lead to problems of perceived favoritism or arbitrary approvals/denials, and this creates an inherent risk of discrimination claims. For example, if one manager does not reasonably grant vacation approvals, this may create feelings of unfairness in his or her subordinates. Policies and procedures must be consistently followed, and approvals must be fair and reasonably provided in order to minimize these risks.

An unlimited vacation policy may also negatively affect employee morale. Some employees may believe that an unlimited vacation policy is akin to a "no vacation" policy, particularly if the company has a workaholic culture where taking time off is discouraged. Employees may feel a responsibility to limit the amount of vacation time taken, to fit in with their co-workers and the corporate culture. Employers must ensure that the policy and the theory behind it are properly communicated to avoid these types of morale issues.

Misclassification of employees may also impact the effectiveness of an unlimited vacation policy. If employers have been overly aggressive in classifying employees as "exempt," many employees improperly designated as exempt (e.g., administrative assistants) may technically fall within the policy but are not likely well-suited for it.

Finally, because unlimited vacation policies are a relatively new concept, there is really no law – statute, regulation, case law – addressing them. From a legal perspective, this lack of clarity makes it difficult to predict how such policies would be treated under state wage and hour laws, which generally were enacted to regulate traditional, accrual-based vacation policies. Accordingly, employers must tread carefully and seek legal advice as they contemplate a switch.

Other Considerations

Apart from the financial and administrative considerations, companies who are considering switching to an unlimited vacation policy must also carefully consider the practical impact of making such a change. For example, whether employees are responsible and accountable enough to manage their vacation time and workload effectively, whether the change would be consistent with the culture of the company, and how the new policy will impact recruiting and retention of employees are all considerations which must be carefully weighed before making a change.

Making the Transition

If an employer with a traditional vacation policy decides to shift to an unlimited vacation policy, it must also consider how to treat existing accrued leave benefits under the previous vacation policy. In many states, accrued vacation is form of vested wages. This leads to the question of how employers must treat the vested vacation balances of employees if they switch to an unlimited vacation policy. Depending on applicable state law, employers which switch to an unlimited vacation policy may have several options for dealing with the existing accrued vacation balances of employees.

First, employers may simply cash employees out by paying them for their accrued, unused vacation at the time of the change. This option may be costly, but can be implemented quickly and efficiently. Second, employers may allow employees a reasonable period of time to draw down their balances before implementation of the new policy. Under state law, employers may have to give reasonable notice to employees prior to making a switch in vacation policies, in order to allow employees to use their existing benefits prior to the change.[3] This option may greatly reduce, or even eliminate, any cost associated with the change, but will take time to implement.

Other options include tracking separately the accrued balance under the traditional vacation policy and paying it out upon termination of employment, or implementing some combination of the options described above. State law may dictate which options may be implemented.[4]

Bottom Line

Unlimited vacation policies are worth considering as a way to ease the administrative and financial burden associated with traditional accrual policies and to increase flexibility for exempt employees. However, despite the potential benefits, these policies are not for every employer, and companies should carefully consider the potential pitfalls and legal risks that attend to such policies and the shift away from a traditional model.

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1 While not clear, California's Division of Labor Standards and Enforcement apparently (in the experience of the authors) enforces a cap of no of less than 1.5 times the yearly accrual rate.

2 For example, California law permits employers to deduct partial day absences of four hours or more from an employee's accrued vacation balance. *Conley v. Pacific Gas & Electric Co.*, 131 Cal. App. 4th 260 (2005).

3 *See, e.g.*, *Department of Labor Standards Enforcement Policies and Interpretations Manual* § 15.1.4.1 (2002).

4 For example, under California law an employer is obligated to pay out accrued vacation upon termination of employment. Cal. Labor Code § 201. However, California law does not require an employer to pay out accrued vacation when it implements a change to its vacation policy.