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Companies can impose a waiting period on paid vacation accrual

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A California auto detail business required its employees to work for at least one year before earning vacation. An employee left after six months and received no vacation pay upon his departure. He sued the company, claiming it unlawfully required him to forfeit his accrued vacation pay. The trial court dismissed the lawsuit because the company's written policy unambiguously and lawfully stated that employees did not earn vacation during the first year of employment. The California Court of Appeal agreed.

Employee sues over vacation policy

The written vacation policy implemented by Automobile Creations, Inc., and Dynamic Auto Images, Inc., states:

All employees earn [one] week of vacation after completion of one year [of] service and a maximum of two weeks' vacation after two years of service. This means that after you have completed your first anniversary with the company, you are entitled to take one week of paid vacation, and after the completion of two years' service, you will accrue two weeks [of] paid vacation

per year. This does not mean that you earn or accrue 1/12th of one week's vacation . . . each month during your first year. You must complete one year of service with the company to be entitled to one week [of] vacation.

Nathan Minnick worked for the auto companies for six months. Consistent with company policy, he did not receive any vacation wages in his final paycheck because he had been employed for less than one year.

Minnick sued, alleging the auto companies' vacation policy violates California law because it requires employees who work for less than one year to forfeit vested vacation pay. He asserted claims for (1) failure to pay all wages upon termination, (2) violation of California's unfair competition law, and (3) penalties under California's Private Attorneys General Act of 2004 (PAGA).

The trial court granted the auto companies' motion to dismiss. Minnick appealed, and the court of appeal affirmed.

Vested vacation pay constitutes earned wages

Vacation time constitutes wages for services performed. Similar to pension or retirement benefits, vacation pay is a

form of deferred compensation that vests as it is earned and may not be forfeited. Although California law does not require businesses to provide employees paid vacation, if it is included as a component of employee compensation, the employer may not reclaim it after it has been earned.

Unless the benefit is otherwise addressed by a collective bargaining agreement, an employer must pay a departing employee all accrued but unused vacation at the employee's final rate of pay. Notably, if vacation pay is not earned, it is not vested, and an employee is not entitled to unvested vacation pay upon termination of the employment relationship.

Minnick's vacation pay did not vest under the policy

The court of appeal found Minnick's challenges to the auto companies' vacation policy unpersuasive. As he conceded, an employer may lawfully opt out of providing paid vacation. By logical extension, an employer is not required to allow vacation pay to vest beginning on the first date of employment. If an employer can lawfully restrict vacation accrual at the back end by capping the amount of vacation that can be earned, it follows that the employer can lawfully impose a waiting period at the front end.

The auto companies' vacation policy unambiguously imposes a waiting period. The policy states that before employees "earn" a vacation benefit, they must complete one year of service. The example in the policy makes clear that an employee does not "earn" or "accrue" vacation in the first year of service and therefore is not entitled to a prorated amount of vacation pay during the first year.

Minnick argued that the policy could be construed to mean that completing the first year of employment is a condition to obtaining *pay* for the vacation benefit that vested during that first year. The court of appeal found that to be an unreasonable interpretation. In the context of the policy, the language reasonably informs employees that their vacation accrual begins *after* the completion of their first year.

The court of appeal also rejected Minnick's assertion that the auto companies were unlawfully attempting to "contract around" the ban on forfeiture of wages. Logically, wages cannot be forfeited unless they are first earned. An employer has the authority to "front-load" vacation benefits, permitting the employee to take a one-week paid vacation during his second year even before it is fully earned, but also to provide that if the employee leaves before the end of the second year, he will be entitled to only a prorated share of the benefit (the vested portion). That would not constitute a forfeiture of vested vacation benefits. *Minnick v. Automotive Creations, Inc.* (California Court of Appeal, 4th Appellate District, 7/28/17).

Bottom line

Vacation pay is not a guaranteed benefit under California law. As a result, employers have wide discretion in deciding how much vacation to offer and determining the conditions for vesting. From the employee's perspective, a company's vacation policy is generally perceived as a significant component of his compensation. To avoid a misunderstanding and potential legal disputes, it is important to spell out vacation policies in straightforward, unambiguous language.

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