



STOKES WAGNER

ATTORNEYS AT LAW

ATLANTA • ITHACA • LOS ANGELES • PITTSBURGH • SAN DIEGO • SAN FRANCISCO

California Appellate Court Issues Guidelines on “Unlimited” Vacation Policies in *McPherson v. EF Intercultural Foundation, Inc.*

Unlimited vacation policies have gained popularity in recent years, both with employees and employers. These policies allow employees can take as much time off as their responsibilities allow, and relieve employers of the administrative burden of tracking PTO accrual, use, and payout. Even more attractive to the employers is the proposition that an unlimited PTO policy avoids the requirement of paying out accrued but unused PTO at the end of employment. For traditional PTO accrual policies, earned vacation is considered wages, and [Labor Code Section 227.3](#), requires an employer to payout earned but unused vacation time upon separation. In contrast, under unlimited PTO policies, employees do not accrue and “bank” vacation hours to use later; rather they are entrusted to take time off at their election, so long as they complete their work and perform as expected.

On April 1, 2020, a California Court of Appeal for the first time addressed unlimited PTO policies, clarifying the payout requirement under Labor Code Section 227.3. In [McPherson v. EF Intercultural Foundation, Inc.](#) three exempt employees sued their employer for unpaid vacation wages that were not paid out upon separation. The employer described its vacation policy as “unlimited,” but it was neither conveyed as unlimited to the plaintiffs, nor was it unlimited in practice. EF impliedly limited the time available for vacation approval to no more than six weeks and never formalized the “unlimited” policy in writing. This resulted in the employee plaintiffs taking less vacation time under an “unlimited” policy than other employees under a traditional accrual policy.

The court found that EF could not avoid section 227.3 by leaving its vacation policy “undefined.” Based on the particular facts of the case, section 227.3 indeed applied to EF’s purported “unlimited” paid time off policy. Simply calling a paid time off policy “unlimited” while in practice limiting the amount of vacation an employee can take does not absolve the employer of the vacation payout requirement under section 227.3. In effect, EF’s vacation policy robbed employees of their end of employment payout. It is important to note that the decision is narrowly tailored to EF’s vacation policy and does

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not necessarily apply to all legitimately unlimited vacation policies. Employers should examine their vacation policies in practice and in effect to determine whether their policies are legitimately unlimited. Fortunately, the court provided guidance on what *may* constitute a valid unlimited time off policy that does not violate section 227.3.

An unlimited paid vacation policy should:

- 1) Be in writing;
- 2) Clearly provide 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;
- 3) Spell out the rights and obligations of both employee and employer and the consequences of failing to schedule time off;
- 4) In practice allow sufficient opportunity for employees to take time off, or work fewer hours in lieu of taking time off; and
- 5) Be fairly administered 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.

While these are helpful suggestions from the Court, they likely come in *dicta* which is not controlling law. Nevertheless, employers using or considering using unlimited PTO policies should review their policies and consult with counsel to ensure they align with the holding in *McPherson*.

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