A Timely Analysis of Legal Developments

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**In This Issue:**

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In a case of first impression, California's Sixth District Court of Appeal lays down a new test for distinguishing sabbaticals from vacations for purposes of pay out upon termination.

# California Appellate Court Answers the Question "What Is Vacation?"

**By Margaret Gillespie**

During these last few weeks of summer, California's Sixth District Court of Appeal has issued a decision opining on the meaning of "vacation." The decision is important because it provides guidance to California employers regarding the circumstances under which unused Paid Time Off (PTO) benefits must be paid out upon termination.

In *Paton v. Advanced Micro Devices, Inc.*, No. H034618 (Aug. 5, 2011), the plaintiff became eligible for, but never took, an eight week paid sabbatical. According to the employer's sabbatical program, the paid leave would be forfeited if it was not used while the employee remained employed with the company. When the plaintiff resigned and did not receive any pay-out for his unused sabbatical, he brought a class action lawsuit claiming that the sabbatical was the legal equivalent of extra vacation for long-term employees. As a result, plaintiff argued, an eligible employee who did not use the eight (8) weeks of paid time off should be paid for any unused portion upon termination, just as he would be paid for accrued and unused vacation.

The appellate court reversed summary judgment in favor of the employer, finding that the question of whether the employer's particular sabbatical program granted a legitimate sabbatical (which does not have to be paid out upon termination), or was a subterfuge for additional vacation time, could not be answered based upon the facts before it. In reaching its decision, the court set out a four-part test for determining whether paid time off qualifies as a sabbatical and, by extension, when paid time off must be treated as vacation.

## Factual Background

Advanced Micro Devices established its sabbatical program in 1986. Under the original program, all full-time salaried employees in good standing were eligible for an eight-week paid sabbatical after seven years of service. The sabbatical had to be taken within two years of eligibility, and employees whose employment terminated before they took the sabbatical forfeited it. The express purpose of the sabbatical program was to "encourage continued employment with [the company] by providing time away from work for enrichment and revitalization." It was conceived as a way to retain talent in the

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competitive world of Silicon Valley chip designers, whose employees frequently were recruited by the competition. The program was revised several times, and ultimately discontinued in 2009.

At all pertinent times, the company also maintained a separate paid vacation policy. The amount of paid vacation increased annually up to a maximum of four weeks by the time the employee reached the eighth year of service.

After the plaintiff had worked for the company for more than seven years, he planned to take his sabbatical but was asked to defer it for business reasons. He later was placed on a performance improvement plan, which rendered him ineligible for the sabbatical. Had he returned to good standing, he would have been eligible for the sabbatical once again. Rather than complete the performance improvement plan, the plaintiff chose to resign. He was surprised to learn that he would not be paid for the sabbatical, and filed a claim with the California Department of Industrial Relations' Division of Labor Standards Enforcement (DLSE). The DLSE denied his claim, at which point he filed his class action complaint in court.

## Legal Background

No employer is required to offer paid vacation as a benefit. If an employer decides to do so, however, it must comply with the pertinent laws covering vacation accrual, vesting, and payment.

In California, "use it or lose it" vacation policies have long been illegal. As set forth in California Labor Code section 227.3, when "an employee is terminated without having taken off his vested vacation time, all vested vacation shall be paid to him as wages at his final rate." Moreover, "an employment contract or employer policy shall not provide for forfeiture of vested vacation time upon termination." In *Suastez v. Plastic Dress-Up Co.*,[1] the California Supreme Court held that paid vacation constitutes a form of wages, which vests on a pro rata basis as the employee works. Thus, all earned but unused vacation must be paid out upon termination.

After the *Suastez* decision came down, California's Labor Commissioner became concerned that employers would attempt to avoid the *Suastez* requirements by offering "sabbaticals" as a form of paid time off that would not accrue or require pay-out upon termination. In an attempt to address these concerns, California's DLSE issued a series of opinion letters attempting to draw a distinction between legitimate sabbaticals and a subterfuge to avoid having to pay out vacation upon termination. The DLSE developed a three-part test to define a sabbatical, which no court had adopted or interpreted until the *Paton* court.

## The Court's Definition of Vacation

The first question the *Paton* court set out to answer is what is "the nature of vacation." The court began its analysis by noting that no court or statute previously had defined the term *vacation*. From its review of the case law to date, the court determined that *vacation* should be defined as "paid time off that accrues in proportion to the length of the employee's service, is not conditioned upon the occurrence of any event or condition, and usually does not impose conditions upon the employee's use of the time away from work." Thus, paid time off that is designated for a specific purpose (such as sick leave) does not have to be treated like vacation or paid out upon termination. Similarly, paid time off that is contingent on the occurrence of a specific event (such as a holiday) does not require a pay-out upon termination. In short, "paid time off that is given without condition is presumed to be vacation."

## A New Four-Part Test for Sabbaticals

Having defined vacation, the court turned to defining what makes a sabbatical different. In contrast to vacation, the court noted, sabbaticals originated as a conditional type of paid leave granted to university professors for study or travel, during which "the faculty member engages in a project intended to promote his or her professional development and, in turn, enhance the institution's status." According to the court, the employee on a traditional sabbatical is expected to use the time off for activities that will enhance his or her value to the employer. As a result, such leave is conditioned upon the employee spending his or her time on specified activities, meaning it falls outside the definition of vacation (which is given without condition).

To aid in the analysis, the court devised a new four-part test for determining whether paid time off qualifies as a true sabbatical that does not have to be paid out upon termination. The test incorporates the DLSE's three-part test, with one additional factor added by the court:

- Frequency: leave that is granted infrequently tends to support the assertion that the leave is intended to retain experienced employees who have devoted a significant period of service to the employer. According to the court, "Every seven years is the traditional frequency and it seems an appropriate starting point for assessing corporate sabbaticals, as well. In many cases, an interval of seven years would be long enough for an employee to gain experience and demonstrate expertise that an employer might want to retain. Greater or lesser frequency could be appropriate depending upon the industry or particular company involved."
- Length: the length of the leave should be longer than that "normally" offered as vacation. As the court stated, "Since regular vacation time may be used for rest, a sabbatical ought to provide the extended time off work that regular vacation does not."
- Additional benefit: a legitimate sabbatical will always be granted in addition to regular vacation, and the regular vacation should be comparable to that offered by comparable employers. "Because an employer could offer a minimal vacation plan and reward senior staff with sabbaticals as a way to avoid the financial liability of a more generous vacation plan, the employer's regular vacation policy should be comparable to the average vacation benefit offered in the relevant market."
- Return to work: Since a sabbatical is designed to retain valued employees, then a legitimate sabbatical program should incorporate some feature that demonstrates that the employee taking the sabbatical is expected to return to work for the employer after the leave is over.

Although not identified as a separate factor, the court's analysis also turned on the purpose of the paid time off. If the purpose is for rest and relaxation, then it falls under the category of vacation. If the purpose is to retain valued employees who will "enhance their future service to the employer" upon return from leave, then the leave may qualify as a true sabbatical.

Applying these factors to the sabbatical program before it, the court found conflicting evidence on the employer's purpose in establishing the sabbatical program. For that reason, the court remanded the case to the trial court for determination of this "ultimate fact."

## Practical Impact

In devising and implementing their PTO programs, employers should be aware of which types of paid time off must be paid out upon termination, and should clearly state the purpose for which a particular paid time off benefit may or may not be used. If the paid time off may be used for any purpose, then it accrues like vacation on a *pro rata* basis as the employee works; and, any accrued and unused time must be paid out upon termination. If the paid time off may be used only for a specific purpose or upon the occurrence of a specific event, then the employer's written policies should make that clear.

For those employers who offer sabbatical programs, they should review their programs to make sure that the sabbatical benefit is offered no more frequently than once every seven years or so, that it is longer than the amount of vacation the eligible employee can accrue at one time, that the employee also retains his or her vacation benefits, and that the purpose of the sabbatical is spelled out in the policy as being offered to retain long-term employees, who are expected to use the sabbatical to enhance their contributions to the company upon their return.

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[1] 31 Cal. 3d 774 (1982).