Singing The Siren Song Of Unlimited Vacation Policies

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Unlimited vacation policies continue to captivate employers. For some, it is simply a way to reduce financial liabilities, while for others the promise of one less administrative task alone is enough to make the concept attractive. Some companies see “unlimited vacation for all” as consistent with their egalitarian company cultures, while others view it as a nifty recruiting tool to further distinguish the company from its competitors.

Regardless of an employer’s motivation, however, the devil is in the details when it comes to unlimited vacation policies. For instance, what may at first glance appear to be a straightforward concept is much more nuanced to the trained eye — especially given the expansion of paid sick leave legislation trending across the U.S. (e.g., California’s recently enacted statewide paid sick leave law) — and even more surprising when viewed through an international lens.

Defining the Issue

Before even considering implementing an unlimited vacation policy, it is critical to understand what this concept entails, which itself goes by many different monikers. Whether referred to as “open vacation,” “unlimited free time,” “unlimited paid time off,” or “flexible vacation” — or the label of choice for this article of “unlimited vacation” — contrary to all of these catchy names, it is not a free pass for employees to take as much vacation as they want within (or without) reason. Nor, as its more jaundiced critics sometimes suggest, is it subterfuge to discourage employees from taking any time off at all.

Unlimited vacation is a flexible time-off strategy that, if applied to the right workforce in the right location with the right management, can at least somewhat ease an employer’s administrative burdens and reflect the intended company culture without compromising its compliance with relevant laws on paid leave. If rolled out haphazardly, however, or left to languish in employee handbooks without oversight or occasional iteration, these types of policies can be more trouble than they are worth and ultimately ill-advised.
Going Meta: Figuring Out the “Motivation” for Converting to Unlimited Vacation

As when devising any new company policy, it is important for an employer’s human resources and legal departments to work closely with their business partners to determine what it is they are “solving for” at the outset.

**Cost-Savings**

Employers in California are familiar with the state’s stringent rules on vacation. Specifically, accrued and unused vacation or PTO (i.e., paid time off employees may use for any reason, without condition) constitutes wages that must be paid out upon an employee’s voluntary or involuntary termination. Because use-it-or-lose-it policies are prohibited in California, an employee’s vacation balance can grow to be sizable and require a hefty payout come time of exit, which in an at-will employment world is unpredictable and largely out of the employer’s control.

Many other states, such as Texas and New York, leave final payout of vacation within an employer’s discretion. It is therefore not uncommon for companies with employees in multiple jurisdictions to adopt a nationwide policy of including vacation accruals in an employee’s final pay. Such companies, if experiencing high turnover or an upswing in “regretted” departures (e.g., due to talent wars or otherwise) can find themselves juggling significant outlays in final wages from quarter to quarter. Because vacation does not accrue under an unlimited vacation model, conversion to such a model avoids any obligation to pay out such accruals upon termination.

**Reduced Administrative Burden**

Another benefit of converting to an unlimited vacation policy is administrative: Vacation that does not accrue does not have to be monitored and tracked against available vacation balances. Moreover, no vacation balances means the accuracy of such balances (which inevitably relies to some degree on an employee’s self-reporting) ceases to be an issue. The mobile nature of work and conflation of work with life — Who hasn’t taken their laptop on holiday? — has made such self-reporting increasingly difficult and ill-suited to the realities of the workplace, particularly with respect to exempt employees. As a result, many companies believe their accounting of employee vacation balances is inaccurate or inflated. This in turn leads to higher payments than necessary being made during unpaid leaves of absence, such as under the Family Medical Leave Act, which allows employers to require substitution of accrued and unused vacation, and, where applicable, upon termination.

**Culture**

Similarly, employers and employees alike have grown disillusioned with tracking the vacation of exempt employees on the basis that this kind of
regimen clashes with the culture of trust and mutual respect the employer is trying to build with its exempt-level workforce. The idea is it seems disingenuous to expect your professional employees to immerse themselves in what they are doing and still segregate their activities into buckets of “paid time on” (e.g., work) versus “paid time off” (e.g., vacation), especially when, regardless of how the time is sliced and characterized, the employees are being compensated the same. Further, for many companies, providing the same unlimited vacation benefits to all eligible employees fosters stated company values of equal contribution and importance in the organization. Unlimited vacation therefore is interpreted by many employers as being more transparent and progressive, as well as a talent and retention (and attraction) tool.

Scoping the Policy: Deciding Who is Eligible for Unlimited Vacation and When

Exempt vs. Nonexempt Employees

While in theory exempt and nonexempt employees alike can be afforded unlimited vacation, the recommended best practice is to restrict this benefit to exempt employees only. First, accrued vacation enables employers to better manage the productivity of hourly workers. Moreover, because the comings and goings of nonexempt employees must be recorded anyway to comply with state and federal wage and hour law, it is far less onerous to monitor the vacation and use by these employees; a mandatory time-keeping system already is in place. Finally, the cultural tensions discussed above are less relevant to nonexempt employees since, as a matter of law, such employees are prohibited from working off the clock, including during vacation.

Interaction with Unpaid Statutory Leaves

It is also important not to confuse unlimited vacation with statutorily protected leaves, such as FMLA or a disability leave of absence taken pursuant to the Americans with Disabilities Act or California’s pregnancy disability leave law (“PDL” or “state-maternity leave”). Unlimited vacation should not convert these unpaid leaves into a potentially lengthy paid time off.

Most companies want unpaid leaves of absence to remain unpaid, save for the application of short-term disability insurance, workers’ compensation or other state wage-substitution programs, such as California’s Paid Family Leave benefit. Notwithstanding this, however, employers are free in their business judgment to provide whatever paid fringe benefits they want to keep their workforce motivated as well as to stay competitive. A prime example is offering paid parental leave to cover a portion of an employee’s FMLA or state-maternity leave for the birth or adoption of a child. Thus, some companies coordinate rollout of an unlimited vacation policy that excludes sick leave and leaves of absence with announcement of a paid parental leave policy.
Mandatory Paid Sick Leave

Employers operating in jurisdictions with mandatory paid sick leave laws have additional considerations to address. Depending on applicable sick leave accrual and carryover rules, they will want to ensure employees converted to unlimited vacation do not lose any accumulated paid sick leave and, furthermore, continue to accrue their rightful number of sick days in the future.

But doesn’t the concept of unlimited paid time-off include unlimited paid sick days? It certainly can, but it is not recommended. Consider the potential unintended consequences. Unlimited paid sick leave opens up the door to extended paid leaves of absence due to illness or disability, including leaves taken pursuant to the FMLA, state-maternity leave, the ADA and worker’s compensation leave. Moreover, in jurisdictions like San Francisco, New York City and California that entitle employees to use their allotted sick leave to care for ill or injured family members, unlimited sick days can result in employees being able to take lengthy paid leaves for their family members’ health conditions.

Accordingly, the decision to combine unlimited vacation and unlimited paid sick leave should not be made lightly. As such, the best practice is to cap (and track) accrued sick days used for employee or family member illnesses or doctor’s appointments consistent with applicable law, and save unlimited vacation for just that, vacation only.

Conversion Tactics: What to do with Current Vacation Accruals?

Once an employer decides to migrate some or all of its workforce to an unlimited vacation model, it next has to consider what to do with vacation accruals currently on its books.

In this context employers generally have two options: (1) immediate cash out to all affected employees or (2) gradual exhaustion of accruals over time. While this latter approach helps mitigate the immediate financial impact on a company, it also requires the continued monitoring of vacation balances until exhaustion and causes the conversion to unlimited vacation to be tiered rather than all at once. Note, however, that under either scenario all future vacation accruals should end for those being converted to an unlimited vacation system.

Going Global: Can it be Done Internationally?

For companies with operations outside of the U.S., employers’ HR and in-house legal departments are undoubtedly braced for the next, inevitable question: Can we do this globally? As with many U.S. employment law concepts and practices, the idea of unlimited vacation, or “holiday” as referred to in most of the world, does not quite translate outside of the U.S.
Why? Well, because at the most basic level, unlike in the U.S., vacation is a legal entitlement in most countries, not a fringe benefit that employers can chose to offer or not. As such, most employees in the world are statutorily entitled to vacation. These statutory vacation entitlements cannot be reduced by the employer unilaterally, nor can they be reduced even with employee consent. Further, in many jurisdictions, taking of vacation is considered an important health and safety issue. As such, not only are there minimum statutory vacation entitlements, most often based on years of service, but employees are required to actually take their vacation during the year — think of August in France. For that reason, the motivation to implement an unlimited vacation policy in the U.S. simply does not translate internationally.

For instance, the potential cost savings that can come from unlimited vacation policies in the U.S. (i.e., no accrual of vacation liabilities on the books) is not as present abroad, where employers are required to offer (and thus carry) certain accruals. With that said, for companies that have been generous and offered above and beyond the local statutory vacation entitlement, there might be some cost savings if they are able to get employees to agree to a reduction back to statutory minimums. In order to do so, the first step is to determine what is being offered to employees (i.e., is the company offering vacation above and beyond statutory minimums). If so, then the next step is to calculate the potential cost savings if entitlements are reduced to the statutory minimums. Like in the U.S., depending on the jurisdiction, the employer may need to provide notice of the change in advance, and employee consent (and possibly notice and consultation with works councils, unions and employee representatives) will be required. Additionally, the change can only be prospective (i.e., current accrued vacation generally cannot be forfeited).

Similarly, because the employer still must track vacation usage as to statutory entitlements, the potential benefit of easing administrative burdens is minimal. Finally, the perceived cultural benefit does not translate effectively given that in most jurisdictions, vacation entitlements are seniority based, and, in others, employees at different levels as determined by applicable national collective bargaining agreements are entitled to different amounts of vacation.

Despite all these challenges when viewing unlimited vacation from a U.S. perspective, some companies have readily adjusted their frame of reference. There is a growing trend toward providing unlimited vacation outside of the U.S. for those companies motivated to distinguish themselves in foreign markets when recruiting. In so doing, those companies acknowledge at the outset that employees have statutory minimum entitlements to which the company is adding another benefit of unlimited vacation. The key considerations in those instances are to ensure that the unlimited vacation policies are clearly drafted to mitigate
against the benefit becoming an acquired right, the potential for claims of
discrimination if not granted by managers equitably, application to unpaid
leaves and abuse of the policy, as well as effective implementation of the
policy in terms of any notice or consultation obligations, translations, and
amendments to agreements or work rules.

Planning to Plan: An Unlimited Vacation Checklist

Once a company makes the decision to dive in, the following basic
checklist for charting a shift to unlimited vacation is a good place to start:

• Figure out who the unlimited vacation policy will apply to and why.
• Identify where the policy will be applied, and, importantly, whether it
  will have application outside of the U.S.
• Determine if the company will offer paid sick leave and/or other paid leave
  (e.g., paid parental leave) to subsidize unpaid statutory leaves of absence.
• Review and update all employment agreements, handbooks and
  policies that discuss the use of vacation or paid time off (e.g., leaves of
  absence, illness and time-off benefits).
• Review any offer letters/employment contracts to confirm there are no
  existing contractual obligations to provide vacation or paid time off.
• In the U.S., plan to continue tracking time off taken for family medical
  leave under the FMLA and state equivalents, and for other statutory
  leaves that provide specific amounts of protected time off to employees
  (e.g., pregnancy leaves and military leaves).
• Outside of the U.S., plan to continue to track statutory vacation, as well
  as time taken off for leaves.
• Prepare a written notice to impacted employees explaining when the
  unlimited vacation policy will take effect and how current vacation
  accruals will be handled. Note that some jurisdictions, both foreign and
  domestic, may require specific advance notice before any changes to
  paid vacation policies. Determine which countries outside of the U.S.
  will require amendments to employment agreements, work rules or
  handbooks (and translations), and plan for any notice or consultation
  obligations.
• In the U.S., consider conducting an audit of current vacation accruals to
  ensure no more vacation is paid out upon conversion to unlimited
  vacation than necessary and employees are left a bank of accrued paid
  sick leave, if required by state or local ordinance. Outside of the U.S.,
  consider conducting an audit of current accruals, in conjunction with the
  local payroll provider, to ensure that statutory entitlements are met.

If after making it through all of these planning considerations the
company is still ready for the switch to unlimited vacation, half the battle
will have been won. And when it’s all said and done lead by example and
take a holiday!