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Colorado Supreme Court Bans "Use-It or Lose-It" Vacation Policies

On Monday, June 14, 2021, the Colorado Supreme Court issued a long-awaited decision prohibiting so-called “use-it or lose-it” vacation policies. In *Nieto v. Clark's Market*, 19SC553, the Supreme Court overturned both the trial court and the lower appellate court to hold that the Colorado Wage Claim Act (CWCA) prohibits the forfeiture of earned vacation pay at the end of employment, even when an employment agreement or policy provides that accrued vacation is not paid out upon separation.

We have discussed this hot topic before. In 2019, the Colorado Department of Labor and Employment (CDLE) reversed its earlier guidance and issued regulations that prohibited use-it or lose-it policies. The Supreme Court has now affirmed the CDLE regulations and resolved at least one major topic in this long-standing debate.

Background

In *Nieto*, an employer did not pay a discharged employee her accrued but unused vacation pay in her last paycheck. The company’s employee handbook provided that discharged employees “forfeit” their vacation pay. Many Colorado employers, including multi-state employers with Colorado operations, have policies that specify vacation is not paid out at separation, although they are rarely as explicit about forfeiture as the employer in *Nieto*. Based on past guidance from the CDLE and several lower Court opinions, employers often restricted the payout of vacation pay under the theory that vacation is to be taken during employment, not stockpiled for payment post-employment.

The Supreme Court, interpreting the CWCA text, purpose and legislative history, held that all “earned” and “determinable” vacation pay must be paid at the end of the employment relationship regardless of the terms of any

employer-employee agreement, including those in an employee handbook. The CWCA requires employers offering paid vacation to "pay upon separation from employment all vacation pay earned and determinable in accordance with the terms of any agreement between the employer and the employee." Colo. Rev. Stat. § 8-4-101(14)(a)(III).

The crux of this dispute is that the CWCA defines "wages" as amounts that are "earned, vested, and determinable." However, the vacation payout provision within subsection 14(a)(III) only requires vacation pay to be "earned" and "determinable." The omission of the term "vested" from the vacation payout provision had been the subject of multiple lower Court decisions that upheld employer use-it or lose-it policies. The Supreme Court disregarded the "vested" portion of the wages definition by reasoning that "vested" may be synonymous with "earned" and that the more specific payout provision trumps the general definition of wages. The Court also found that the CWCA general protections of wages and compensation apply to vacation pay and that the law's remedial purpose would be contradicted if earned and unused vacation pay could be lost through a separate agreement.

Based on the above, the Court concluded that vacation pay cannot be forfeited once earned by the employee and that the employer's provision purporting to forfeit the employee's earned but unused vacation pay was void.

What this means to you

1. How does this decision impact my current vacation pay policies?

Colorado employers must pay out accrued and unused vacation time upon an employee's separation. Employers can no longer condition when and how vacation pay is "earned" and "determinable" at separation. Any policy or agreement that purports to forfeit an employee's accrued but unused vacation pay upon the employee's separation is now void and unenforceable.

Employers should revise their policies or agreements to remove such provisions. Because policies with widespread impact are particularly susceptible to class-based litigation, and the financial consequences of wage-and-hour litigation can be substantial, large employers in particular will want to act quickly to ensure their policies comply with this decision.

Multi-state employers already have experience with the variations among conflicting state wage-and-hour laws, particularly for employers operating in jurisdictions such as California. Colorado is among those states that require employers to scrutinize their policies to ensure local compliance.

2. Do I now have to provide vacation pay to my employees?

No, the Supreme Court's decision makes clear that the CWCA does not entitle an employee to vacation pay. However, if an employer provides vacation pay, any accrued and unused vacation must be paid out at the end of the employment relationship.

3. What are an employer's options in response?

A likely outcome of the decision is that Colorado employees will now be incentivized to save up accrued vacation time for payout on separation. This can create significant financial liability, particularly for long-term employees, that must be carried on an employer's books. It also undermines the morale of a workforce that is not taking advantage of an employer's vacation benefits.

Employers can address these problems in a few ways. Employers are permitted to impose a cap on their employees' accrual of vacation time. Employers can also consider moving to a flex vacation policy that does not provide for the accrual of vacation time, but instead grants employees the discretion to take vacation when their schedules permit. Of course flex vacation policies are not a perfect solution, creating their own set of challenges. Particularly in lower-wage industries, this decision unfortunately will likely result in some employers reducing or eliminating vacation benefits.

4. Does this decision extend to paid time off (PTO) policies?

We wish we could say for certain. PTO encompasses various types of leave, including sick leave, personal leave and vacation. In the past, the CDLE advised that PTO is not subject to the vacation payout provision of the CWCA, in large measure because sick leave and personal leave are not paid out upon separation of employment.

However, caution is in order in light of the CDLE's recent reversal in its guidance and the *Nieto* decision. With the prevalence of PTO in the workplace, the CDLE and the Courts will likely be providing guidance of some sort in the near future.

5. Does this decision void other use-it or lose-it vacation provisions outside the employee separation context?

It appears so. While the Court did not specifically address use-it or lose-it vacation provisions that apply pre-separation, its holding likely means that employees can no longer require their employers to use or lose vacation time in a given year. Because the decision entitles employees to all earned and determinable vacation pay, vacation will eventually be payable regardless of when it was accrued.

Contact us

If you have questions about complying with employee vacation accrual in Colorado or a related issue in the changing labor & employment landscape, please contact Barb Grandjean, Ashley Jordaan, Chris Ottele, Sonia Anderson, Owen Davis or your Husch Blackwell attorney.