One Minute Memo®

Court of Appeal Rings the Bell for California Employers: Vacation Benefits May Be Paid At A Rate Less Than Employee's Normal Rate of Pay

Since 1982, California has required employers to treat vacation pay as a benefit that vests during employment, and to pay for unused vacation upon termination. Employers generally have paid employees on vacation at their rate of pay then in effect, and not at some other rate, such as the rate in effect when the employee earned the vacation benefit. Now, however, the California Court of Appeal has recognized that employers can, prospectively, specify vacation benefits for current employees in an amount that differs from the employee's current rate of pay. *Bell v. H.F. Cox, Inc.* (September 5, 2012).

Case Background

Oscar Bell and other truck drivers sued their employer, H.F. Cox, Inc., to challenge its vacation policy. The policy provided that eligible employees earned paid vacation annually, in a number of weeks that increased with the length of service. The policy provided, however, that drivers would receive vacation pay in the amount of $500 per week (increased in 2005 to $650 per week), and that terminated employees would receive no vacation pay at all.

The truck drivers asserted that this policy violated California Labor Code section 227.3. Section 227.3 requires that, unless otherwise provided by a collective-bargaining agreement, employers must pay terminating employees all vested vacation at the employee's "final rate in accordance with" the "contract of employment or employment policy respecting eligibility or time served." Pursuant to a 1982 California Supreme Court interpretation (in the *Suastez* case), Section 227.3 requires employers to pay employees, upon termination, all earned, unused vacation time, on a theory that earned vacation pay is a vested benefit that cannot be forfeited.

As to current employees, the trial court granted summary adjudication to Cox, reasoning that Cox could lawfully pay current employees on vacation at a rate less than their normal rate of pay. As to terminated employees - who received no vacation pay at all under an employee benefit plan that Cox contended was governed by ERISA and thus not subject to Section 227.3 - the trial court found a triable issue as to whether vacation benefits were truly funded in a separate trust, as ERISA requires.

The Court of Appeal Holding

The Court of Appeal affirmed summary adjudication for the employer as to vacation pay for current employees. The court observed that an employer need not provide vacation pay at all, and that an employer can stop the accrual of vacation pay in order to keep employees from accumulating unused vacation in excess of specified limits. Moreover, the Court of Appeal held that Section 227.3 applies only where an employee terminates, and thus by its express terms does *not* apply to vacation benefits paid during current employment. For these reasons, the employer could establish an earnings schedule for vacation pay for current employees at whatever level it chose.

What *Bell* Means for Employers

Under *Bell*, employers may enforce a policy of paying *current* employees for their vacation time at a specified rate that may be less than their normal rate of pay. Thus, the *Bell* ruling will permit employers to offer the benefit of vacation time at a reduced, predictable cost.

But could Cox pay that predetermined level of vacation benefit to terminating employees? *Bell* had no occasion to address that question, because for terminating employees Cox relied on what it thought was an ERISA-protected employee benefit plan, under which it paid terminating employees no vacation pay at all. There is some loose language in *Bell* that might be misread to imply that terminated employees must be paid unused weeks of vacation at the employee's final wage rate. But the better view is that used vacation pay for a terminated employee, under Section 227.3, would be due at the same rate that the employee would have received had the employee gone on vacation instead of terminating employment. *Bell*, unfortunately, provides no explicit guidance on this issue.

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