Employment Edge 80th Edition - Minnesota Supreme Court: Employers Have Freedom to Set Terms of Vacation and PTO Policies

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In a November 15 decision, the Minnesota Supreme Court cleared up much of the recent confusion regarding whether unused vacation and PTO must be paid to an employee at the end of employment. In Lee v. Fresenius Medical Care, Inc., the Court held that employers have the right to determine, through their policies, when an employee is eligible to be paid for unused vacation and PTO time. This decision gives employers greater freedom to define the parameters of their vacation and PTO policies. It is also an important reminder that an employer should review its current policies to ensure they are clearly drafted and accurately state the employer's intent.

The Court's Decision

In Lee, the Supreme Court considered a challenge to an employer's PTO policy, which appeared in the employer's employee handbook. The policy provided for pay out of accrued PTO when an employee resigned with proper notice, but for no pay out if the employee resigned without proper notice or if the employee was terminated for misconduct. Susan Lee, who was terminated for misconduct, challenged the policy under Minnesota Statutes Section 181.13(a), which requires employers to pay all wages due to a terminated employee promptly upon the employee's demand. Lee argued that accrued but unpaid vacation time was "wages," and that she had a statutory right to payout of her unused PTO regardless of her employer's policy.

In August 2006, the Minnesota Court of Appeals ruled in favor of Ms. Lee, holding that PTO benefits could not be forfeited under any circumstances because of the wage payment statute. This decision created a great deal of confusion for employers because it became uncertain whether use-it-or-lose-it vacation and PTO policies were lawful in Minnesota. The Supreme Court's November 15 ruling reverses the 2006 Court of Appeals decision and holds that employers have the right to determine, under their vacation and PTO

policies, the circumstances under which employees will be eligible for payment of PTO and vacation time.

The key to whether an employee has a right to be paid for accrued PTO or vacation time, according to the Court, is the "contractual" understanding the employer establishes with its employees about the terms and conditions of its PTO or vacation policy. Since an employer is not required by statute to offer paid vacation at all, the Court reasoned that an employer is free to set the terms of its vacation policy, including the conditions under which it will pay for vacation time accrued by its employees.

What Does It Mean For Employers?

According to the Court, employers have the right to "set conditions that employees must meet to exercise their earned right to vacation time with pay." The court specifically approved of certain common restrictions including:

- *Pre-Approval:* policies may require approval for use of vacation/PTO;
- *"Use or Lose:"* policies may require employees to use accrued vacation/PTO within set time limits or forfeit accrued benefits;
- *Accrual Caps:* policies may set a maximum for employee's accrued but unused vacation/PTO;
- *No Payment at Termination:* policies may refuse to provide a payout of vacation/PTO upon termination or upon termination for cause or if the employee does not give adequate notice; and
- *Buyback:* policies may refuse to provide a payment at any point for accrued vacation/PTO.

The decision also confirms the importance of carefully crafted employment policies. The employer was successful in this case because its policy was clearly written, the employee was given a copy of the policy in the employer's handbook, and the employee signed an acknowledgment of receipt. If the employer had not had a policy or if it had not distributed the policy to employees, it likely would have been required to pay Lee her accrued but unused PTO.

In addition, the decision revisited an important issue regarding whether employee handbooks are considered contracts under Minnesota law. It is important that employers draft their handbooks keeping in mind that each policy may be considered a contract, binding on both the employee and the employer — as was the case here. On the other hand, handbook disclaimers that there is no intent to create a contract must also be carefully considered in light of this decision.

Employers should review their current vacation and PTO policies in light of this decision to ensure that the policies are clearly written and express the employer's preferred policy choices. If changes are made to these policies, the changes must be communicated to employees. For assistance with review of vacation and other paid leave policies or other employment policies please contact Dorraine Larison, Mark Mathison, Sam Diehl or another member of the Gray Plant Mooty Employment and Labor Law Practice Group.