Pay Up: Colorado Supreme Court Clarifies Vacation Payout Obligations

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Colorado law has long been unsettled as to whether employers must pay out accrued but unused vacation time at separation of employment where the employer's vacation policy recites that vacation time need not *be paid out at separation (*e.g., *because certain conditions, like voluntary separation, or the employee's provision of two weeks' notice, are not satisfied). But no longer. The Colorado Supreme Court decided a case on June 14, 2021, addressing this issue head-on, and held that "all earned and determinable vacation pay must be paid upon separation and that any agreement purporting to forfeit earned vacation is void." The Supreme Court's decision also appears to invalidate "use-it-or-lose-it" vacation policies in Colorado going forward.*

Background on *Nieto v. Clark's Market*

The Supreme Court's decision arose from the case of *Nieto v. Clark's Market*, in which an employer declined to pay an employee's accrued but unused vacation time at separation of employment because the employee had been discharged, and the employer's vacation policy provided that, "[i]f you are discharged for any reason or do not give proper notice, you will forfeit all earned vacation pay benefits." The employer argued that the terms of this vacation policy controlled whether accrued but unused vacation time must be paid out at separation of employment, and the employee argued that, under the Colorado Wage Claim Act ("CWCA"), vacation time which is earned and determinable must *always* be paid out at separation – *regardless of what the employer's vacation policy says about such payout*.

At issue in *Nieto*, and a similar case decided by the Colorado Court of Appeals in 2020, was how to properly interpret the CWCA. In pertinent part, the Act instructs that "wages" or "compensation," as defined in the Act, includes:

> Vacation pay earned in accordance with the terms of any agreement. If an employer provides paid vacation for an employee, the employer shall 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.

Employers have long argued that the Act's reference to vacation pay earned "in accordance with the terms of any agreement between the

employer and employee" demonstrated that vacation payout rules *as defined in the employer's own vacation policy* controlled whether accrued, unused vacation time must be paid out at separation. Employers have also recently argued – with success before the Colorado Court of Appeals – that vacation pay must not only be "earned" and "determinable" to be paid out at separation, but must also be "vested" – since the CWCA provides that "[n]o amount is considered to be wages or compensation until such amount is earned, *vested*, and determinable . . . ." Based on the language in another Colorado Supreme Court case addressing vacation pay (albeit in the context of identifying marital property for purposes of Colorado's divorce laws), employers have also had success recently in arguing before the Colorado Court of Appeals that vacation pay is never "vested" when an employer's vacation policy does not require the payout of vacation time upon separation.

On the other hand, the Colorado Department of Labor and Employment, Division of Labor Standards and Statistics (the "Division"), has issued ambiguous guidance on the legality of "use-it-or-lose-it" vacation policies in past years, but has more recently taken the consistent position that vacation time, once accrued, can never be taken away from employees – either at separation of employment, or pursuant to "use-it-or-lose-it" vacation policies. ("Use-it-or-lose-it" policies generally provide that all accrued vacation time must be used by the end of the year, or else will be "lost" and cannot be used going forward.) In rebutting employers' arguments that the terms of their vacation policies control whether accrued, unused vacation time must be paid out at separation of employment, the Division has pointed in particular to a provision in the CWCA which recites that "[a]ny agreement, written or oral, by any employee purporting to waive or to modify . . . employee's rights in violation of the [CWCA] shall be void."

In 2019 – and in response to the Colorado Court of Appeals cases in which employers were having success in arguing that the terms of their vacation policies control whether accrued, used vacation time must be paid out at separation – the Division also issued "emergency" rules (which later became permanent) which codified its position that vacation policies may *never* allow a forfeiture of accrued vacation time. These rules permit employers to decide whether employers provide vacation time at all; the amount of vacation time provided (per year or other period); and whether vacation time accrues all at once, or over specific periods (*e.g.*, proportionally each week, month, etc.). The Division's rules also permit vacation policies to place a "cap" on the accrual of vacation time – of one year's worth (or more) of vacation – but instruct that such policies may never permit forfeiture of any accrued vacation amounts. Instead, accrued vacation time may only be diminished through an employee's use. The effect of the Division's new rules was to effectively invalidate "use-it-or-lose-it" vacation policies in Colorado, but whether these rules were a permissible interpretation of the CWCA was an open question – at least before *Nieto*.

Colorado Supreme Court's Decision in *Nieto*

In confronting this legal landscape, the Colorado Supreme Court in *Nieto*

first held that – notwithstanding the CWCA's provision reciting that "[n]o amount is considered to be wages or compensation until such amount is earned, *vested*, and determinable" – "vested" means the same thing as "earned" under the CWCA, or, alternatively, the "vested" requirement does not apply to vacation time under the Act (as opposed to other types of "wages" or "compensation" that must be paid out under the Act). The Supreme Court found that the employee at issue in *Nieto* had "earned" her vacation time because vacation time was awarded under the employer's policy for work already performed, and the Court further found that the amount of the employee's earned vacation time was "determinable" (*i.e.*, could be ascertained).

The Supreme Court rejected the argument that the CWCA's reference to vacation pay being earned "in accordance with the terms of any agreement between the employer and employee" demonstrated that vacation payout rules *as defined in the employer's own vacation policy* control whether vacation time must be paid out at separation. Although the Court found this statutory language to be ambiguous, it analyzed the Act's purpose, language and structure, and legislative history, along with the Division's own interpretation of this language (in the 2019 rules referenced above), and held that if an employer chooses to provide vacation time, any contract term which purports to forfeit such time – like the forfeiture clause in the employer's vacation policy in *Nieto* – is void under the CWCA as an agreement "purporting to waive or to modify" employees' rights.

Ultimately, the Supreme Court concluded that "[a]lthough the CWCA does not create an automatic right to vacation pay, when an employer chooses to provide such pay, it cannot be forfeited once earned by the employee."

The End of "Use-It-or-Lose-It" Policies?

While the Supreme Court's decision in *Nieto* invalidated an employer's vacation policy purporting to forfeit accrued, unused vacation time at separation of employment, the decision's logic seems to apply equally to "use-it-or-lose-it" policies. The Court did not extensively discuss such policies in its decision, but its holding that once an employer chooses to provide vacation pay, any contract term that purports to forfeit such pay is void, would seem to apply equally to forfeitures effected by "use-it-or-lose-it" policies. The Supreme Court in *Nieto* also discussed the Division's 2019 rules – which, as discussed above, effectively invalidate "use-it-or-lose-it" vacation policies – and recited (albeit without discussing "use-it-or-lose-it" policies directly) that these new rules were "consistent with the statute's purpose, language, structure, and legislative history."

While the Colorado Supreme Court's decision in *Nieto* appears to close the door to "use-it-or-lose-it" policies going forward, the decision could prompt derivative litigation on related issues. For instance, if employers award vacation time *prospectively*, rather than in return for *past service*, is such time actually "earned" within the meaning of the CWCA? Does the Supreme Court's decision apply equally to paid time off ("PTO"), even though the CWCA only expressly discusses the compensability of "vacation" pay? The *Nieto* decision also contains an ambiguous footnote relating to the number of unused vacation days that the employee in *Nieto*

had accrued – and this footnote may also spawn additional litigation over whether it is logically consistent – or not – with the rest of the decision's holdings.

While such issues may ultimately result in additional rulings fleshing out the precise reach of the Supreme Court's decision in *Nieto*, the Court – at a minimum – seems to be signaling very strongly that most (or maybe all) "use-it-or-lose-it" vacation policies are not likely to be viable in Colorado going forward.

Conclusion

In light of the Colorado Supreme Court's decision in *Nieto*, employers should likely assume that "use-it-or-lose-it" vacation policies are very unlikely to be defensible going forward, and should revise their polices to ensure that once vacation time is accrued, it is never forfeited (either at separation of employment, or at year's end pursuant to a "use-it-or-lose-it" policy). Employers will likely be obligated to pay out such compensation at separation of employment regardless of what their vacation policies provide. Since the Supreme Court's decision in *Nieto* also broadly sanctioned the Division's 2019 rules pertaining to payout of vacation time, employers should additionally consider these rules carefully to decide whether they can limit vacation payout liability by imposing a "cap" of one year's worth (or more) on vacation accruals. Capping vacation accruals is not the same as forfeiting accrued, unused vacation time, but it can have a similar effect in limiting employers' ultimate payout liability at separation of employment.
